

Chapter 7

Suspension of dealings,
termination of authorised
funds and side pockets

7.8 Side pockets

Application

7.8.1

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- (1) Subject to (2), this section applies to:
 - (a) the *authorised fund manager* of an *AUT*, *ACS* or an *ICVC*;
 - (b) any other *director* of an *ICVC*;
 - (c) the *depository* of an *AUT*, *ACS* or an *ICVC*; and
 - (d) an *ICVC*,which is a *UCITS scheme* or a *non-UCITS retail scheme*.
- (2) This section does not apply to a *scheme* which is a *regulated money market fund*.

7.8.2

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- (1) This section sets out the terms on which the *authorised fund manager* of a *scheme* holding *affected investments* can segregate those *affected investments* from the other assets held in the *scheme property* by establishing a *side pocket class*.
- (2) The purpose of the *rules* in this section is to advance the *FCA's* consumer protection and integrity objectives (see s1B(3) of the *Act*) by helping *authorised fund managers* deal with the consequences of the Russian invasion of Ukraine.
- (3) The *rules* in this section apply other *rules* in *COLL*, where necessary, with appropriate modifications, as well as imposing certain additional requirements.

Financial sanctions regimes relating to Russia

7.8.3

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- (1) The definition for a 'sanctioned investment' in the *Glossary* (which is incorporated in the definition for 'affected investment') relates to the financial sanctions regimes of the Group of 7 (G7) countries comprising Canada, France, Germany, Italy, Japan, the *United Kingdom* and the *United States of America*, plus the *EU*, as those sanctions regimes relate to Russia.
- (2) Before deciding whether to create a *side pocket class* and determining the arrangements under which the *class* is to operate, the *authorised fund manager* will need to understand the legal requirements and obligations that apply under the relevant financial sanctions regimes. The *authorised fund manager* will need to be

satisfied that creation of the *side pocket class* and the operational arrangements for the *class* will comply with those regimes.

- (3) The *UK's* financial sanctions regime is set out in the Russia (Sanctions) (EU Exit) Regulations 2019. The Regulations are available at <https://www.legislation.gov.uk/ukSI/2019/855/contents>. The *UK* regime prohibits certain types of activity and conduct, including dealing with funds and economic resources, and dealing with transferable securities and money-market instruments, subject to certain exceptions. Contravention of these prohibitions constitutes a criminal offence.
- (4) The Office of Financial Sanctions Implementation (OFSI) (part of HM Treasury) helps to ensure that the *UK* financial sanctions regime is properly understood, implemented and enforced in the *United Kingdom*.

Conditions for creating a side pocket class

7.8.4

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- (1) If all the conditions in (2) are satisfied, the *authorised fund manager* of a *scheme* holding *affected investments* in the *scheme property* may, after consulting with the *depository*, create a *side pocket class*.
- (2) The conditions are:
 - (a) The *authorised fund manager* has determined that the *affected investment* in (1) is:
 - (i) a *sanctioned investment*;
 - (ii) a *unit* in a *collective investment scheme* or a *share* in an *AIF* within the meaning of paragraph (2)(b)(vii) of the definition of 'affected investment'; or
 - (iii) to the extent not in (i) or (ii), an *affected investment* for which there are no accurate, reliable and regular prices.
 - (b) The *authorised fund manager* has determined that:
 - (i) creating the *side pocket class* will protect the interests of *unitholders*;
 - (ii) the rights of any *unit* in a *side pocket class* will not be unfairly prejudicial to the interests of *unitholders* generally or to the *unitholders* of any other *class* of *units* in the *scheme*;
 - (iii) the *issue* of *units* in the *side pocket class* will be in the best interests of *unitholders*, the *authorised fund* and the integrity of the market; and
 - (iv) all the *unitholders* in the *authorised fund* will be treated fairly.
 - (c) The *instrument constituting the fund* and the *prospectus*:
 - (i) provide for the *issue* of *units* in a *side pocket class*; and
 - (ii) set out the terms on which that *class* will operate, in accordance with the *rules* in, and applied by, this section (see in particular **COLL 7.8.13R** (Modified application of COLL 4.2 (Pre-sale notifications))).

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- (3) Before making the determination in (2)(b), the *authorised fund manager* must consider:
 - (a) at least each of the matters specified in ■ COLL 7 Annex 1 (Matters to be considered by the authorised fund manager before creating a side pocket class); and
 - (b) whether it would be in the interest of all the *unitholders* in the *authorised fund* to suspend *dealings* in *units* in accordance with ■ COLL 7.2.1R (Requirement) instead of creating a *side pocket class*.
- (4)
 - (a) The decision to create a *side pocket class* pursuant to (1) must be taken by the *authorised fund manager's governing body*.
 - (b) The *authorised fund manager* must make a record of the *governing body's* decision and the reasons for it.

Side pocket classes

- (1) The *authorised fund manager* may:
 - (a) issue *units* in a new *class* to *unitholders* in the *authorised fund*; or
 - (b) convert a *unit* in an existing *class* into *units* in one or more new *classes*.
- (2) Where the *authorised fund manager* has taken an action pursuant to (1)(a) or (1)(b), it must determine the *price* of *units* of each existing and new *class* by reference to a valuation of the portions of *capital property* and *income property* represented by either:
 - (a) one or more *affected investments* held in the *scheme property*; or
 - (b) the *scheme property* excluding some or any such *affected investments*,as provided for in the *instrument constituting the fund* and the *prospectus*.
- (3) A new *class* within (2)(a) is referred to as a 'side pocket class'.
- (4) The *authorised fund manager* must determine the date and time on which the *units* in the new *class* are to be *issued*.
- (5) On the date and time specified in (4):
 - (a) the combined net asset value of all *units* of the new *class* and all *units* of the existing *class*; or
 - (b) the combined net asset value of any new *classes* of *unit* issued by conversion from an existing *class* of *unit*,must equal the net asset value of all *units* of the *class* or *classes* that existed immediately before the specified date and time.
- (6) On the date and time specified in (4), the number of *units* held by a *unitholder* in a new *class* must be proportionate to the number of *units* held by them in an existing *class* immediately before such date and time.

7.8.6 **R** The *prospectus* of the *authorised fund* must limit the *issue of units* in a *side pocket class* after the date and time specified in **■ COLL 7.8.5R(4)** (see **■ COLL 7.8.30R(5)** (Modified application of COLL 6.2 (Dealing))).

7.8.7 **G**

- (1) An *authorised fund manager* intending to *issue units* in a new *class* will need to consider the effect of section 235(4) of the *Act*. In broad terms, this provides that if the contributions of the *participants* and the profits or income out of which payments are to be made to them are pooled in relation to separate parts of the *scheme property*, the arrangements are not to be regarded as constituting a single *collective investment scheme* unless the participants are entitled to exchange rights in one part for rights in another (see section 235(4) of the *Act* (Collective investment schemes)).
- (2) The *authorised fund manager* of an *ICVC* will also need to consider the effect of section 236(3) (Open-ended investment companies) of the *Act*. **■ PERG 9.6** (The investment condition (section 236(3) of the *Act*): general) sets out the *FCA's* view of this provision. In particular, **■ PERG 9.6.3G** and **■ PERG 9.6.4G** provide *guidance* on situations where an *ICVC* issues shares or securities that may not satisfy the investment condition.

Allocation of scheme property to a side pocket class

7.8.8 **G**

- (1) The *authorised fund manager* will need to consider carefully how to apply a fair accounting treatment when a *side pocket class* is created.
- (2) Where the *unit price* is determined only by reference to *affected investments* that are themselves valued at or close to zero, then a *unit* in the *side pocket class* will have minimal value. Where a portion of the *income property* of the *scheme* is attributable to *affected investments*, the unit price of the *side pocket class* should include that element of income.
- (3) The *authorised fund manager* may determine that a proportion of uninvested cash held in the *capital property* of the *scheme* should be attributed to the *side pocket class*, as a provision against costs and charges attributable to the *class* in the future. This will depend on the *authorised fund manager's* policy for the treatment of costs and charges (see also **■ COLL 7.8.36R** (Modified application of COLL 6.7 (Payments))). If the *side pocket class* has an overdrawn cash position, it should not be netted off against a positive cash position attributable to other *classes*.
- (4) Some *authorised fund managers* may wish to use *derivatives* and forward transactions within the *side pocket class* to hedge exposure to currency fluctuations affecting asset valuations, especially if the *affected investments* acquire value at a later point. *Authorised fund managers* may also wish to replicate currency *class* hedging arrangements where these already exist. Such activities will require an allocation of *capital property* to cover transaction costs and margin requirements.
- (5) Decisions whether to undertake the activities in (4) should be taken by the *authorised fund manager* based on its judgment of *unitholders' reasonable expectations* and future best interests. The

authorised fund manager should take particular care to ensure its risk management process is properly applied to analyse the possible harm that could arise from such transactions. See also ■ COLL 7.8.26R (Side pockets: modified application of COLL 5 (Investment and borrowing powers)) and the related guidance in ■ COLL 7.8.27G.

Costs and charges for a side pocket class

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- (1) The *FCA* accepts that a *side pocket class* should bear a proportionate share of the costs and charges which arise and are incurred for the benefit of all *unitholders*, such as depositary expenses and fees, audit fees, and regulatory charges. The *authorised fund manager*, in managing and administering the *authorised fund*, will also incur necessary expenses which it may recover from the *scheme property*. The *FCA* would not expect *unitholders* in *classes* without any interest in the *affected investments* to cross-subsidise the costs and charges of managing the *side pocket class*. Such costs and charges may be recovered in the first instance out of available income or capital attributable to the *side pocket class*, depending on the normal charging policy set out in the *prospectus*.
- (2) Since it is not possible to know whether any income from *affected investments* will be receivable on an ongoing basis in future, the *authorised fund manager* will have to determine how to account for such income and for expenses attributable to the *side pocket class*. The *authorised fund manager* may decide to accrue such costs and charges indefinitely until sufficient cash is available to cover them, or to waive some charges or pay them from its own resources. The *governing body* of the *authorised fund manager* should consider this when evaluating whether to proceed with creating a *side pocket class*.
- (3) The *governing body* should also consider whether the *authorised fund manager* should be remunerated for managing a *class* that is valued largely or solely by reference to *affected investments*. To ensure fair treatment of all *unitholders* in the *fund*, it may be more appropriate for the *authorised fund manager* to forego some or all remuneration from the *side pocket class*.
- (4) An *authorised fund manager* may be able to charge a fee for managing the *side pocket class*, but the fee should fairly reflect the services provided and activities carried on by the *authorised fund manager* for *unitholders* in that *class*. The fee should not exceed what is reasonable to cover the necessary costs and charges of the *authorised fund manager* (including any *firm* which has been given the mandate to *manage investments* for the *scheme* under ■ COLL 6.6.15AR (Committees and delegation)) and to reward the amount of work entailed in seeking opportunities over time to dispose of the *affected investments* in an orderly way. The *FCA* would expect such a fee to be less than the *authorised fund manager's* charges for managing the rest of the *scheme property*.

Application of COLL 3 (Constitution)

7.8.10

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The *rules and guidance* in ■ COLL 3 (Constitution) apply to an *authorised fund* with a *side pocket class* subject to the modifications specified in ■ COLL 7.8.11R.

7.8.11 **R** In ■ COLL 3.3.5R (Rights of unit classes), paragraphs (2) and (3) do not prohibit the *issue of units* in a *side pocket class*.

Application of COLL 4 (Investor relations): General

7.8.12 **R** The *rules and guidance* in ■ COLL 4 (Investor relations) apply to an *authorised fund* with a *side pocket class*, subject to:

- (1) the modifications in ■ COLL 7.8.13R to ■ COLL 7.8.21R; and
- (2) the additional requirements in ■ COLL 7.8.22R and ■ COLL 7.8.24R.

Modified application of COLL 4.2 (Pre-sale notifications)

7.8.13 **R** In relation to a *side pocket class*, the information required to be included in the *prospectus* under ■ COLL 4.2.5R (Table: contents of prospectus) must cover at least the additional matters set out in (1) to (4).

- (1) In ■ COLL 4.2.5R(5) (Characteristics of units):
 - (a) a general description of the *affected investments* to be allocated to the *side pocket class* (or *side pocket classes*);
 - (b) an explanation of how the *scheme property* (both *capital property* and *income property*) will be allocated between the *side pocket class* (or *side pocket classes*) and other *classes* at the outset and on an ongoing basis; and
 - (c) information which explains:
 - (i) that the *authorised fund manager* will seek to dispose of all the *affected investments* over time, on terms that it judges to be in the best interests of *unitholders*; and
 - (ii) that the *units* in the *side pocket class* (or *side pocket classes*) will be *cancelled* when this has been done, indicating where possible what options may be offered to *unitholders* for exiting the *side pocket class* (or *side pocket classes*) under the process.
- (2) In ■ COLL 4.2.5R(16) (Valuation and pricing of scheme property), the frequency at which:
 - (a) *affected investments* allocated to the *side pocket class* will be valued; and
 - (b) the *prices* of *units* in the *side pocket class* will be calculated, where these differ from other *classes* of the *scheme*.
- (3) In ■ COLL 4.2.5R(17) (Dealing):
 - (a) that the *issue of units* in the *side pocket class* is limited, and the circumstances and conditions for *issuing* them;
 - (b) a statement of when the *dealing days* for the *side pocket class* will be;
 - (c) details of any cut-off point for the receipt of *dealing* instructions prior to the *valuation point* for the relevant *dealing day*; and
 - (d) if applicable, details of:

- (i) any special arrangements put in place for *redemptions* of *units* in the *side pocket class*, including any extended time period for settlement and any facility to pay the proceeds of *redemption* to a *person* other than the *unitholder*;
- (ii) whether *redemption* proceeds can be reinvested in *units* of other *classes* of the *scheme* or in *units* of other *schemes*; and
- (iii) any facility for a *unitholder* to dispose of an interest in *units* by transferring title to them to another *person* (other than by operation of law), as a donation or for financial consideration.

(4) In ■ COLL 4.2.5R(27)(b) (Additional information):

- (a) an explanation that there is no certainty that any *affected investment* will ever recover its value to a significant extent, or at all, and that the *authorised fund manager* may be unable to realise any material value for *unitholders* in respect of *units* held in the *side pocket class*;
- (b) if applicable, that the costs and charges for operating the *side pocket class* may significantly erode the returns from any realisable value from the *affected investments* over time; and
- (c) whether the *authorised fund manager* has undertaken to bear all the costs and charges associated with operating the *side pocket class* from its own resources and, if not, a statement explaining:
 - (i) the risk that costs and charges might cause the cash position of the *side pocket class* to become overdrawn;
 - (ii) that a liability arising as a result of (i) would be accounted for against the *scheme property* allocated to the other *classes* in the *scheme*; and
 - (iii) the steps the *authorised fund manager* would take to ensure *unitholders* in other *classes* do not bear such a liability.

Modified application of COLL 4.3 (Approvals and notifications)

7.8.14 **R** The *authorised fund manager* need not treat the creation of a *side pocket class* as a fundamental change for the purposes of ■ COLL 4.3.4R (Fundamental change requiring prior approval by meeting) provided the *authorised fund manager* is satisfied on reasonable grounds that the foreseeable costs of this course of action are not disproportionate to the benefits.

7.8.15 **G** The *guidance* in ■ COLL 4.3.5G (Guidance on fundamental change) should be read in accordance with the modification in ■ COLL 7.8.14R.

7.8.16 **R** If the *authorised fund manager* considers that the creation of a *side pocket class* constitutes a significant change, the *authorised fund manager*:

- (1) may, but need not, give prior written notice to *unitholders* under ■ COLL 4.3.6R(1) (Significant change requiring pre-event notification); and
- (2) is not required to comply with ■ COLL 4.3.6R(3).

7.8.17 **G** The *guidance* in ■ COLL 4.3.7G (Guidance on significant changes) should be read in accordance with the modification in ■ COLL 7.8.16R.

7.8.18 **G** Before announcing its intention to create a *side pocket class*, the *authorised fund manager* should have regard to the reasonable operational needs of *intermediate unitholders* and any reasonable periods of time they will need to establish processes and procedures and communicate information to those *clients* for whom the *intermediate unitholder* acts as a nominee in relation to *units* in the *scheme*.

Modified application of COLL 4.4 (Meetings of unitholders and service of notices)

7.8.19 **R**

- (1) ■ COLL 4.4.8R (Voting rights) applies to an *authorised fund* with a *side pocket class* with the modifications set out in (2) and (3) below.
- (2) Before a resolution is put to a vote at a *unitholder* meeting, it must be made clear whether the resolution relates to or affects:
 - (a) all the *classes of unit* in the *authorised fund*;
 - (b) those *classes of unit* in the *authorised fund* excluding the *side pocket class*; or
 - (c) only the *side pocket class*.
- (3) On a poll, the votes of a *unitholder* may only be counted to the extent that the *unitholder's* voting rights are attached to *units* in the *class* or *classes* to which the resolution relates or which the resolution affects in accordance with (2).

7.8.20 **G**

- (1) The *authorised fund manager* will need to ensure that the *instrument constituting the fund* and the *prospectus* reflect the modified application of ■ COLL 4.4.8R as set out in ■ COLL 7.8.19R.
- (2) ■ COLL 7.8.19R modifies the application of ■ COLL 4.4.8R but does not affect the other matters dealt with in ■ COLL 4.4, such as ■ COLL 4.4.6R (Quorum).

Modified application of COLL 4.7 (Key investor information and marketing communications)

7.8.21 **R** The *rules* in ■ COLL 4.7.2R (Key investor information) do not require an *authorised fund manager* to draw up a *key investor information document* or a *NURS-KII document* in relation to a *side pocket class*.

Additional information for unitholders on the creation of a side pocket class

7.8.22 **R** The *authorised fund manager* must provide a written notification to *unitholders* which meets the requirements of (1) to (3).

- (1) The notification must be provided to *unitholders* in a timely way, either shortly before the *side pocket class* is created or as soon as practicable afterwards.

- (2) If the *unitholder* has a financial adviser, the requirement to provide the notification in (1) may be satisfied by sending it to the financial adviser.
- (3) The notification must explain in a comprehensive manner:
 - the reasons for the *authorised fund manager's* decision to create a *side pocket class*, including the expected benefits and the costs and charges;
 - the effect on *unitholders'* ability to exercise their rights;
 - if applicable, the basis on which the *authorised fund manager* has satisfied itself as to the cost impact of its decision under ■ COLL 7.8.14R;
 - a description of the main features of the *side pocket class*;
 - practical information that *unitholders* will need to understand about the changes to their investment in the *authorised fund*;
 - and
 - each of the matters specified in ■ COLL 7.8.13R(4) (Modified application of COLL 4.2 (Pre-sale notifications)).
- (4) The notification must:
 - (a) be written in clear and plain language;
 - (b) be provided in a *durable medium*; and
 - (c) be accessible by existing and prospective *unitholders* (e.g. by publishing a copy in a prominent location on the *authorised fund manager's* website).

7.8.23

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- (1) In relation to ■ COLL 7.8.22R(3)(a), the information in the notification should include:
 - (a) a description of the *scheme's* exposure to *affected investments* and the *authorised fund manager's* approach to valuing them;
 - (b) an explanation of the risks such *affected investments* pose to the *scheme* and its *unitholders*, and the *authorised fund manager's* policies for mitigating those risks;
 - (c) a description of what measures the *authorised fund manager* is taking as a result of those risks, and in relation to which *affected investments*;
 - (d) either a detailed list of the *affected investments* or a link to a place where they are (or will be) set out, making clear (if applicable) which *affected investments* are not subject to any of the measures referred to in (c); and
 - (e) an explanation of the costs and charges to be borne by *unitholders* in the new *classes*, and of any resulting change in the costs and charges borne by existing *classes*.
- (2) In relation to ■ COLL 7.8.22R(3)(d), the information in the notification should include:
 - (a) the name of each *side pocket class* and a description of how the rights of a *unitholder* differ from the rights attached to existing *classes* and any other new *classes*;

- (b) any alteration in the rights attached to an existing *class* (e.g. that it will be valued without reference to *affected investments*);
 - (c) the terms on which new *units* are *issued* to existing *unitholders*, i.e. whether *units* in a new *class* are *issued* in addition to *units* in an existing *class*, or by way of conversion into *units* in one or more new *classes*;
 - (d) the terms on which *units* are *issued* to both existing and new *unitholders*; and
 - (e) the date on which the changes take effect.
- (3) In relation to ■ COLL 7.8.22R(3)(e), the information in the notification should include:
- (a) an explanation of the *dealing* arrangements for *redemptions*, including the *dealing days*;
 - (b) if applicable, that *dealing* in *units* in the *side pocket class* has been suspended (see also ■ COLL 7.2.1R(2A), ■ (2B) and ■ (2C) (Requirement));
 - (c) when and how *redemption* proceeds will be paid, including any alternative arrangements for payment;
 - (d) the circumstances in which *unitholders* may convert their *units* in a *side pocket class* to *units* of another *class* of the *scheme*; and
 - (e) the circumstances in which *unitholders* may transfer title to their *units* in the *class* to another *person*.

7.8.24 **R** The authorised fund manager must, as soon as reasonably practicable after the date on which the *side pocket class* is created, send a written statement to each *unitholder* confirming the number and type of *units* of each *class* the *unitholder* holds in the *authorised fund* as a result of the creation of the *side pocket class*.

7.8.25 **G** The notification required by ■ COLL 7.8.22R and the written statement of holdings required by ■ COLL 7.8.24R may be issued to existing *unitholders* in a single combined communication. However, it will not be possible to use a single combined communication where the notification required by ■ COLL 7.8.22R is provided to a *unitholder's* financial adviser instead of the *unitholder* (see ■ COLL 7.8.22R(2)).

Side pockets: modified application of COLL 5 (Investment and borrowing powers)

7.8.26 **R**

- (1) ■ COLL 5 (Investment and borrowing powers) applies to the *side pocket property*, subject to the modifications in this *rule*.
- (2) Subject to (4) to (6), in the case of a *UCITS scheme*, the *authorised fund manager* must comply with as much of ■ COLL 5.1 (Introduction), ■ COLL 5.2 (General investment powers and limits for UCITS schemes) and ■ COLL 5.3 (Derivative exposure) as is practicable having regard to the limited purpose for which the *side pocket class* was created.
- (3) Subject to (4) to (6), in the case of a *non-UCITS retail scheme*, the *authorised fund manager* must comply with as much of ■ COLL 5.1

(Introduction) and ■ COLL 5.6 (Investment powers and borrowing limits for non-UCITS retail schemes) as is practicable having regard to the limited purpose for which the *side pocket class* was created.

- (4) The *authorised fund manager* may only enter into a *derivative* or a forward transaction which:
 - (a) is a 'class hedging transaction' within the meaning of ■ COLL 3.3.5R(4)(d); and
 - (b) falls within ■ COLL 3.3.5AR (Hedging of unit classes) (see also ■ COLL 3.3.5BG (Guidance on hedging of unit classes)), and all provisions of ■ COLL 5 relevant to such transactions apply.
- (5) ■ COLL 5.5.3R (Cash and near cash) applies, except that references to the 'investment objectives' of the *scheme* should be read as references to the objective in ■ COLL 7.8.33R(2)(b) (Modified application of COLL 6.6 (Operating duties and responsibilities)).
- (6) The following rules apply:
 - (a) ■ COLL 5.5.4R (General power to borrow);
 - (b) ■ COLL 5.5.5R (Borrowing limits);
 - (c) ■ COLL 5.5.6R (Restrictions on lending of money);
 - (d) ■ COLL 5.5.7R (Restrictions on lending of property other than money);
 - (e) ■ COLL 5.5.8R (General power to accept or underwrite placings); and
 - (f) ■ COLL 5.5.9R (Guarantees and indemnities).

Side pockets: guidance on modified application of COLL 5

7.8.27

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- (1) The nature of a *side pocket class* means that the *authorised fund manager* cannot apply the same risk controls to *affected investments* that would apply to the rest of the *scheme property*. In the FCA's view, it would not be practicable for the *authorised fund manager* to apply a prudent spread of risk to the *affected investments* or to comply in full with the specific eligibility and risk-spreading limits set out in ■ COLL 5 for *transferable securities*, money-market instruments and *units* in *collective investment schemes*.
- (2) However, the modification of the rules provided in ■ COLL 7.8.26R(2) and ■ (3) is to be interpreted narrowly and only to the extent necessary to allow the *authorised fund manager* to manage the risks of the *affected investments* allocated to the *side pocket class* and to *deal* efficiently with them. In particular, the modifications in those *rules* do not permit an *authorised fund manager* to take any action that increases the risk profile of the *scheme* as a whole, such as acquiring property or entering into transactions that would not be permitted by the unmodified *rules* of ■ COLL 5.

COLL 5 references to ‘scheme property’ in relation to other parts of the scheme

- 7.8.28 **R**
- (1) This *rule* applies to the *authorised fund manager* and *depository* of an *authorised fund* with a *side pocket class*.
 - (2) For the purpose of interpreting references to the ‘scheme property’ in ■ COLL 5 in relation to the part of the *scheme* which is not a ‘side pocket’, the *authorised fund manager* and *depository* may disregard the *side pocket property*.
 - (3) The reference to a ‘side pocket’ in (2) is a reference to a part of the *scheme* which is represented by *units* in a *side pocket class*.

**Application of COLL 6 (Operating duties and responsibilities):
General**

- 7.8.29 **R**
- The *rules* and *guidance* in ■ COLL 6 (Operating duties and responsibilities) apply in relation to an *authorised fund* with a *side pocket class* subject to the modifications specified in ■ COLL 7.8.30R (Modified application of COLL 6.2 (Dealing)) to ■ COLL 7.8.36R (Modified application of COLL 6.7 (Payments)).

Modified application of COLL 6.2 (Dealing)

- 7.8.30 **R**
- (1) ■ COLL 6.2 (Dealing) applies to a *side pocket class* subject to the modifications specified in this *rule*.
 - (2) For the purposes of ■ COLL 6.2.8R (Issue and cancellation of units through an authorised fund manager), if the *authorised fund manager* redeems a *unit* in a *side pocket class* from a *unitholder*, the *authorised fund manager* must immediately *cancel* the *unit* or, in relation to an *AUT* or *ACS*, instruct the *depository* to do so.
 - (3)
 - (a) Subject to (b) and (c), the requirement in ■ COLL 6.2.13R (Payment for units issued) may be satisfied by the *authorised fund manager* allocating such proportion of the *scheme property* to that *class* as the *authorised fund manager* may determine.
 - (b) Before making the allocation of *scheme property* in (a), the *authorised fund manager* must consult the *depository* and take its views into account.
 - (c) After being consulted under (b), the *depository* must consider the proposed allocation of the *scheme property* and inform the *authorised fund manager* if it considers that the allocation is not appropriate, having regard to the purpose of the *side pocket class*.
 - (4) In ■ COLL 6.2.16R (Sale and redemption), in relation to the *redemption* of *units* in a *side pocket class*:
 - (a) paragraphs (4) and (5) apply unless the *prospectus* makes alternative provision for how *unitholders* may be paid; and
 - (b) paragraphs (5A), (6) and (7) do not apply.
 - (5) The *authorised fund manager* must apply ■ COLL 6.2.18R (Limited issue) as follows:

- (a) ■ COLL 6.2.18R(1) applies to the *issue* of *units* in a *side pocket class*;
- (b) ■ COLL 6.2.18R(2) does not apply to a *side pocket class*, and the *authorised fund manager* must not provide for the further *issue* of *units* in the same *class*; and
- (c) ■ COLL 6.2.18R(3) applies where a *scheme* has a *side pocket class*.

Modified application of COLL 6.3 (Valuation and pricing)

7.8.31

R

- (1) ■ COLL 6.3 (Valuation and pricing) applies in relation to a *side pocket class* subject to the modifications specified in this *rule* (see also ■ COLL 7.8.32G).
- (2) For the purpose of ■ COLL 6.3.5R (Price of a unit), the *authorised fund manager* must ensure that the price of a *unit* in a *side pocket class* is calculated:
 - (a) by reference to the net value of the *side pocket property*; and
 - (b) in accordance with the provisions of both the *instrument constituting the fund* and the *prospectus*.
- (3) Notwithstanding ■ COLL 6.3.11R (Publication of prices), the *authorised fund manager* must make public in an appropriate manner the *price* of a *unit* in the *side pocket class* after every *valuation point* (see ■ COLL 6.3.4R (Valuation points)), even if the *authorised fund manager* is not holding itself out to *deal* in such *units* at that *valuation point*.

7.8.32

G

The *guidance* in ■ COLL 6.3.12G(1)(a) to ■ (c) is unlikely to be relevant to an *authorised fund manager* when publishing the *price* of a *unit* in a *side pocket class* in accordance with the *rules* in this section.

Modified application of COLL 6.6 (Operating duties and responsibilities)

7.8.33

R

- (1) ■ COLL 6.6 (Operating duties and responsibilities) applies to the *authorised fund manager* and *depository* of an *authorised fund* with a *side pocket class*, subject to the modifications specified in this *rule* and ■ COLL 7.8.34R (Modified application of the assessment of value rules).
- (2) For the purposes of ■ COLL 6.6.3R(3)(a) (Functions of the authorised fund manager), the *authorised fund manager* must make decisions as to the constituents of the *scheme property*:
 - (a) in accordance with the investment objectives and policy of the *scheme*, but may disregard any *affected investment* in the *side pocket property*; and
 - (b) with a view to disposing of those *affected investments* over time as and when the *authorised fund manager* considers this can be done in the best interests of *unitholders*.
- (3) For the purposes of ■ COLL 6.6.4R(1) (General duties of the depository), the *depository* must take reasonable care to ensure that the *scheme* is managed by the *authorised fund manager* in accordance with the matters specified in ■ COLL 6.6.4R(1)(a) to ■ (e) as modified by the *rules* in this section, and ■ COLL 6.6.4R(2) is to be read accordingly.

- (4) (a) The duty in ■ COLL 6.6.14R(2) (Duties of the depositary and the authorised fund manager: investment and borrowing powers) requiring the *authorised fund manager* to rectify at its own expense a breach of ■ COLL 5 (Investment and borrowing powers), or any provision of the *instrument constituting the fund* or the *prospectus*, does not apply to the extent that:
- (i) the breach relates to *affected investments* in the *side pocket property*; and
 - (ii) the *depositary* is satisfied that it is not practicable for the *authorised fund manager* to comply with the relevant rule in ■ COLL 5, the provision of the *instrument constituting the fund* or the *prospectus*.
- (b) ■ COLL 6.6.14R(4), ■ (5) and ■ (6) do not apply to the extent that the breach falls within (a) above.

Modified application of the assessment of value rules

7.8.34

R

When conducting an assessment of value for the purposes of ■ COLL 6.6.20R (Assessment of value) in relation to a *scheme* that has a *side pocket class*, the *authorised fund manager*:

- (1) must consider each of the matters included in ■ COLL 6.6.21R (Table: minimum considerations – assessment of value) in relation to the *scheme* as a whole, including the *side pocket class*, but may adopt a proportionate approach to the assessment as it applies specifically to the *side pocket class*;
- (2) in relation to the *side pocket class*, need not consider a matter included in ■ COLL 6.6.21R if, in all the circumstances, it is not relevant to that *class*;
- (3) must consider whether, to the extent that payments are being made out of the *scheme property* attributable to the *side pocket class* or are being accrued for that purpose, those payments:
 - (a) are justified in terms of the value delivered to *unitholders* in the *side pocket class*; and
 - (b) are not prejudicial to the interests of *unitholders* of other *classes*; and
- (4) must consider whether it remains in *unitholders'* best interests for the *side pocket class* to continue in operation.

7.8.35

G

- (1) In relation to ■ COLL 7.8.34R(1), the *authorised fund manager* should consider the *side pocket class* when carrying out an assessment of value for a *scheme*. A *side pocket class*, because of its special purpose, might in isolation represent poor value according to the standard criteria for assessment, so the *authorised fund manager* should take account of that purpose in order to reach a proportionate assessment. However, where payments are being taken out of the *side pocket property*, the assessment of overall value delivered to *unitholders* in the *scheme* should give due weight to the impact of those payments.
- (2) In relation to ■ COLL 7.8.34R(3)(a), the *authorised fund manager* should consider whether the payments out of *scheme property* can be

justified when compared with the value it reasonably expects that *unitholders* might receive from any eventual disposal of the *affected investments*, taking into account current market conditions and relevant political and economic developments.

- (3) In relation to ■ COLL 7.8.34R(3)(b), it is likely to be unfair or prejudicial to *unitholders'* best interests for costs and charges borne by the side pocket class to be attributable to *unitholders* in other *classes*.

Modified application of COLL 6.7 (Payments)

7.8.36

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- (1) ■ COLL 6.7 (Payments) applies in relation to an *authorised fund* with a *side pocket class* subject to the modifications and additional requirements specified in this *rule*.
- (2) The *authorised fund manager* must not impose any of the following charges or levies on *unitholders* of the *side pocket class*:
 - (a) a preliminary charge or levy when the *units* in the *side pocket class* are *issued*;
 - (b) a charge or levy on the *redemption* or *cancellation* of *units*;
 - (c) a performance-related management fee.
- (3) The *authorised fund manager* must prevent undue costs being charged to the *scheme* and its *unitholders*.

[**Note:** In relation to (3), see also ■ COLL 6.6A.2R(5) (Duties of AFMs of UCITS schemes to act in the best interests of the scheme and its unitholders) and article 17 of the *AIFMD level 2 regulation* (Duty to act in the best interests of the AIF or the investors in the AIF and the integrity of the market).]

Application of COLL 7.2 (Suspension and restart of dealings)

7.8.37

R

- (1) ■ COLL 7.2 (Suspension and restart of dealings) applies in relation to a *side pocket class* subject to the modifications specified in this *rule*.
- (2) The *authorised fund manager* may suspend *dealings* in *units* of a *side pocket class*, while continuing to *deal* in other *classes* of the *scheme*.
- (3) If the *authorised fund manager* suspends *dealings* in accordance with (1), it is not required to carry out any request by a *unitholder* to convert *units* in the suspended *side pocket class* into units of another *class* in which *dealing* continues.
- (4) ■ COLL 7.2.1R applies to the suspension of *dealings* in *units* of a *side pocket class* under (2).