Collective Investment Schemes

Chapter 5

Investment and borrowing powers
5.1 Introduction

Application

5.1.1

(1) Subject to 1(A), COLL 5.1 to COLL 5.5 apply to the authorised fund manager and the depositary 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 depositary 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 depositary 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 depositary 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

(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**

(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**

This table belongs to [COLL 5.1.2G (2)].

<table>
<thead>
<tr>
<th>Scheme investments and investment techniques</th>
<th>Limits for UCITS schemes</th>
<th>Limits for non-UCITS retail schemes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Approved securities</td>
<td>Permissible investment</td>
<td>Maximum limit</td>
</tr>
<tr>
<td>Yes</td>
<td>None</td>
<td>Yes</td>
</tr>
<tr>
<td>Yes</td>
<td>10%</td>
<td>Yes</td>
</tr>
<tr>
<td>Transferable securities that are not approved securities</td>
<td>Yes</td>
<td>None</td>
</tr>
<tr>
<td>Government and public securities</td>
<td>Yes</td>
<td>None</td>
</tr>
<tr>
<td>Regulated schemes other than qualified investor schemes</td>
<td>Yes</td>
<td>None</td>
</tr>
<tr>
<td>Unregulated schemes and qualified investor schemes</td>
<td>No</td>
<td>N/A</td>
</tr>
<tr>
<td>Warrants</td>
<td>Yes</td>
<td>None</td>
</tr>
<tr>
<td>Investment trusts</td>
<td>Yes</td>
<td>None</td>
</tr>
<tr>
<td>Deposits</td>
<td>Yes</td>
<td>None</td>
</tr>
<tr>
<td>Derivatives</td>
<td>Yes</td>
<td>None</td>
</tr>
<tr>
<td>Immovables (i.e real property)</td>
<td>No</td>
<td>N/A</td>
</tr>
<tr>
<td>Gold</td>
<td>No</td>
<td>N/A</td>
</tr>
<tr>
<td>Hedging</td>
<td>Yes</td>
<td>None</td>
</tr>
<tr>
<td>Stock lending</td>
<td>Yes</td>
<td>None</td>
</tr>
<tr>
<td>Underwriting</td>
<td>Yes</td>
<td>None</td>
</tr>
<tr>
<td>Borrowing</td>
<td>Yes</td>
<td>10% (T)</td>
</tr>
<tr>
<td>Cash and near cash</td>
<td>Yes</td>
<td>None</td>
</tr>
</tbody>
</table>

Note: Meaning of terms used:
**Scheme investments and investment techniques** | Limits for **UCITS schemes** | Limits for **non-UCITS retail schemes**
---|---|---
A percentage | an upper limit (though there may be limits of other kinds). temporary only- see COLL 5.5.4R(4) Not applicable | In the case of a non-UCITS retail scheme operating as a FAIF there is no maximum limit - see COLL 5.7.7 R.
"(T)" | | |
"N/A" | | |
"(C)" | | |
5.2 General investment powers and limits for UCITS schemes

Application

5.2.1 This section applies to an ICVC, an ACD, an authorised fund manager of an AUT or ACS and a depositary 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) COLL 5.2.23C R (Valuation of OTC derivatives) also applies to a UK UCITS management company providing collective portfolio management services for an EEA UCITS scheme from a branch in another EEA State or under the freedom to provide cross border services.

Table of application

5.2.2 This table belongs to COLL 5.2.1 R.
### Section 5.2: General investment powers and limits for UCITS schemes

<table>
<thead>
<tr>
<th>Rule</th>
<th>ICVC</th>
<th>ACD</th>
<th>Authorised fund manager of an AUT or ACS</th>
<th>Depository of an ICVC, AUT or ACS</th>
<th>Authorised fund manager of an AUT or ACS, or ACD of an ICVC, that is a regulated money market fund</th>
</tr>
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<tbody>
<tr>
<td>5.2.3R</td>
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<td>x</td>
<td>x</td>
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</tr>
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<td>5.2.4AG</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td></td>
</tr>
<tr>
<td>5.2.5R to 5.2.9R</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td></td>
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<tr>
<td>5.2.9AR</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
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<td>5.2.10R(1)</td>
<td>x</td>
<td>x</td>
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<td>5.2.10R(2)(a)&amp;(b)</td>
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<td>x</td>
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<td>5.2.10R(2)(c)</td>
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<tr>
<td>5.2.10R(3)</td>
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<td>x</td>
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<tr>
<td>5.2.10AR to 5.2.10EG</td>
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<td>x</td>
<td>x</td>
<td>x</td>
<td></td>
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<tr>
<td>5.2.11R to 5.2.20R (excluding 5.2.17AR and 5.2.17BG)</td>
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<td>x</td>
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<tr>
<td>5.2.17AR and 5.2.17BG</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
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<td>5.2.20AR</td>
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<tr>
<td>5.2.20BG</td>
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<td>5.2.21R</td>
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<td>5.2.22R</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td></td>
</tr>
</tbody>
</table>
### Section 5.2 : General investment powers and limits for UCITS schemes

#### 5.2.A

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](https://www.esma.europa.eu/sites/default/files/library/2015/11/07_044.pdf).

#### 5.2.3

(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.

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<table>
<thead>
<tr>
<th>Rule</th>
<th>ICVC</th>
<th>ACD</th>
<th>Authorised fund manager of an AUT or ACS</th>
<th>Depositary of an ICVC, AUT or ACS</th>
<th>Authorised fund manager of an AUT or ACS, or ACD of an ICVC, that is a regulated money market fund</th>
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<tr>
<td>5.2.22AG</td>
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<tr>
<td>5.2.23R(1)</td>
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<tr>
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<td>x</td>
<td>x</td>
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<td>x</td>
</tr>
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<td>5.2.23CR</td>
<td>x</td>
<td>x</td>
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<td>5.2.26R</td>
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<td>x</td>
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<td>5.2.27R</td>
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<td>5.2.28R</td>
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<td>5.2.29R</td>
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<td>5.2.30R</td>
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<td>5.2.34G</td>
<td>x</td>
<td>x</td>
<td></td>
<td></td>
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</tr>
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</table>

Note: x means "applies"
5.2.4 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 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 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 (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

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

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

(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

(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

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.
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]

(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 ]

(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

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]

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]

(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 (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 (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 5.2.10R (1)(a) (Eligible markets: requirements); or

(b) dealt in on an eligible market within COLL 5.2.10R (1)(b); or

(c) admitted to or dealt in on an eligible market within COLL 5.2.10R (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]
5.2.9 **Eligible markets regime: purpose**

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 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]

5.2.10 **Eligible markets: requirements**

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 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 depositary (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 depositary 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

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

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 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 an EEA State;
      (iii) 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 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 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 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 EU law.

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

**Appropriate information for money-market instruments**

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; or which is issued by an authority within COLL 5.2.10BR (1)(a)(i) 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  (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  (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 Directive 78/660/EEC, 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 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 EU law.

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

Spread: general

(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 the Seventh Council Directive 83/349/EEC of 13 June 1983 based on Article 54(3)(g) of the Treaty on consolidated accounts 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]

5.2.11A

Guidance on spread: general

(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 depositary 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

(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.
Section 5.2 : General investment powers and limits for UCITS schemes

(7) An authorised fund manager of a UCITS scheme must calculate the issuer concentration limits referred to in § COLL 5.2.11R 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

5.2.12 R

(1) This rule applies in respect of a transferable security or an approved money-market instrument ("such securities") that is issued by:

(a) an EEA State;
(b) a local authority of an EEA State;
(c) a non-EEA State; or
(d) a public international body to which 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 depositary 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**

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:
   1. satisfy the conditions necessary for it to enjoy the rights conferred by the **UCITS Directive**; or
   2. be a recognised scheme under the provisions of section 272 of the **Act** (Individually recognised overseas schemes) that is authorised by the supervisory authorities of Guernsey, Jersey or the Isle of Man (provided the requirements of article 50(1)(e) of the **UCITS Directive** are met); or
   3. be authorised as a non-UCITS retail scheme (provided the requirements of article 50(1)(e) of the **UCITS Directive** are met); or
   4. be authorised in another **EEA State** (provided the requirements of article 50(1)(e) of the **UCITS Directive** are met); or
   5. be authorised by the competent authority of an **OECD** member country (other than another **EEA State**) which has:
      1. signed the IOSCO Multilateral Memorandum of Understanding; and
      2. approved the scheme’s management company, rules and depositary/custody arrangements;
      (provided the requirements of article 50(1)(e) of the **UCITS Directive** 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.

### Qualifying non-UCITS collective investment schemes

**5.2.14**

1. COLL 9.3 gives further detail as to the recognition of a scheme under section 272 of the **Act**.

2. Article 50 of the **UCITS Directive** sets out the general investment limits. So, 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 article 50(1)(e) of the UCITS Directive 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:

(a) the rules guaranteeing the autonomy of the scheme and management in the exclusive interest of the unitholders;
(b) the existence of an independent depositary/custodian with similar duties and responsibilities in relation to both safekeeping and supervision; where an independent depositary/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 article 50(1)(e) (first indent) of the UCITS Directive, also applies to schemes (that are not UCITS schemes) established in other 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

(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
Investment in other group schemes

5.2.16

(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

(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**

Where an **authorised fund manager** is exposed to a securitisation that does not meet the requirements provided for in the **Securitisation Regulation**, 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**]**

**Derivatives: general**

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**

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)

(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

(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)


(4) [deleted]

**Transactions for the purchase of property**

5.2.21

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

(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]
5.22A Guidance on requirement to cover sales

[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 depositary 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.

5.23 OTC transactions in derivatives

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; or
   (b) a person whose permission (including any requirements or limitations), as published in the Financial Services Register, or whose Home State authorisation, permits it to enter into the transaction as principal off-exchange;

(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 depositary 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 depositary 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]

5.2.23A 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 In respect of its obligations under COLL 6.6.4 R (1) (a), the depositary 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 (1) For the purposes of COLL 5.2.23 R (2), an authorised fund manager of a UCITS scheme or a UK UCITS management company of an EEA 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 or an EEA 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 or UK UCITS management company 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 and EEA UCITS schemes) or, where appropriate, the equivalent requirements of the UCITS Home
State regulator implementing article 5(2) and article 23(4), second subparagraph, of the UCITS implementing Directive.

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

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

Investment in deposits

5.2.26 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 (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

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 ACSs 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 ACSs, 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

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 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 ACSs); 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 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

(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

(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 or EEA UCITS schemes that employ particular investment strategies

5.2.34

(1) Authorised fund managers of UCITS schemes or EEA UCITS schemes should bear in mind that where a UCITS scheme, or an EEA UCITS scheme that is a recognised scheme under section 264 of the Act, employs particular investment strategies such as those in (2), [COBS 4.13.2R (Marketing communications relating to UCITS schemes or EEA 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

(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 then consider the additional eligibility criteria arising out of the UCITS eligible assets Directive that relate to liquidity, valuations and negotiability (see COLL 5.2.7A R (Investment in transferable securities)).

(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

Authorized 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)

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

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

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)


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)


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

5.4 Stock lending

Application

5.4.1 (1) Subject to (2), this section applies to an ICVC, the depositary 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 COLL 6.6B sets out additional FCA rules applicable to a depositary of a UCITS scheme in relation to the re-use of UCITS custodial assets.

Permitted stock lending

5.4.2 (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 (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
(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

5.4.4

(1) An ICVC, or the depositary 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 depositary for the account of the ICVC, AUT or ACS are in a form which is acceptable to the depositary 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 depositary;

(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 depositary the securities transferred by the depositary 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

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 depositary 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 accordingly makes provision for the treatment of the collateral in that context.

Treatment of collateral

(1) Collateral is adequate for the purposes of this section only if it is:
   (a) transferred to the depositary 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 depositary 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 depositary; 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
      (vi) 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 depositary; or
   (b) the depositary 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 depositary 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 depositary 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 depositary 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.

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)


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


Limitation by value

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

(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 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 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)


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

Section 5.5

5.5 Cash, borrowing, lending and other provisions

Application

5.5.1 Subject to (2), this section applies to an ICVC, an ACD, an authorised fund manager of an AUT or ACS, and a depositary 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 depositary of an ICVC, AUT or ACS, where such ICVC, AUT or ACS is a regulated money market fund.

Table of application

This table belongs to COLL 5.5.1 R.

<table>
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<tr>
<th>Rule</th>
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Note: x means "applies"
Cash and near cash

(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

(1) The ICVC or depositary 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 depositary 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 depositary.

(6) The depositary may only give its consent as required under (5) on such conditions as appear to the depositary 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 (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  
(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  
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  
(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  
(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
**Coll 5: Investment and borrowing powers**

**Section 5.5**

**5.5.7A**

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.

**5.5.8**

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.

**5.5.9**

1. An ICVC or a depositary 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 depositary 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 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 (1) Subject to (3), this section applies to the authorised fund manager and the depositary 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 (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 of the UCITS Directive. Consequently, a scheme authorised as a non-UCITS retail scheme will not qualify for the cross border passporting rights conferred by the UCITS Directive on a UCITS scheme.

(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 schemes which do not comply with the requirements of the UCITS Directive;

(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  
(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 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 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  
(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 immovable 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

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

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  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  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  [deleted]

5.6.5D  [deleted]

Valuation

5.6.6  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  (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 EU 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

(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 depositary 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 depositary).

(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 depositary 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) an EEA State; or
(b) a local authority of an EEA State; or
(c) a non-EEA State; or
(d) a public international body to which 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) satisfies the conditions necessary for it to enjoy the rights conferred by the UCITS Directive; 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

(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 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 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 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 (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)**

(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) A 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 5.3.3CR (Daily calculation of global exposure).
Transactions for the purchase or disposal of property

5.6.14 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 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 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 (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 depositary 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 depositary) and COLL 6.6.14 R (Duties of the depositary 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 (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 depositary and each of the directors of the ICVC or of the authorised fund manager and depositary 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**

(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.

(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 depositary 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) (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 depositary 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 depositary; and

(b) for an ICVC, independent of the ICVC, the directors and the depositary.

(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 depositary 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 UKPS 2.3 of the RICS Valuation Standards (The Red Book) (9th edition published November 2013) 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.

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: Investment and borrowing powers

5.6.21 R

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

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).

5.6.23 R

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).

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.

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.
(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

(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

(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

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) satisfies the conditions necessary for it to enjoy the rights conferred by the UCITS Directive; 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

() the qualifying master scheme:
   (a) is not:
      (i) a feeder 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
      (ii) a feeder NURS; or
      (iii) a scheme otherwise dedicated to units in a single collective investment scheme.

An EEA UCITS scheme that is not a recognised scheme under section 264 of the Act 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 (1) This section applies to the authorised fund manager and the depositary 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 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;
   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
   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 (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.

(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

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 depositary 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

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

1. This rule does not apply in respect of a transferable security or an approved money-market instrument to which COLL 5.6.8 R (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 EU 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

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 depositary 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 depositary).

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 depositary 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

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 is a scheme which satisfies the criteria in COLL 5.6.10 R (1) to (d) or meets each of the requirements at (1) to (4):

1. the second scheme operates on the principle of the prudent spread of risk;

2. 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;

3. 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

4. where the second scheme is an umbrella, the provisions in (1) to (3) and COLL 5.7.5 R (Spread: general) apply to each sub-fund as if it were a separate scheme.
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

(1) A non-UCITS retail scheme operating as a FAIF must not invest in units in schemes in COLL 5.7.7R (1) to (3) (‘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.

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.

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 COL 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 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.
5.8 Investment powers and borrowing limits for feeder UCITS

Application

5.8.1 (1) This section applies to:
(a) the authorised fund manager of a feeder UCITS;
(b) the depositary 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 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 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 under section 264 of the Act.

Balance of scheme property: investment restrictions on a feeder UCITS

5.8.3 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).