

Chapter 5

Investment and borrowing powers

5.2 General investment powers and limits for UCITS schemes

Application

5.2.1

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

(2) [deleted]

Table of application

5.2.2

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This table belongs to ■ COLL 5.2.1 R.

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

Rule	ICVC	ACD	Authorised fund manager of an AUT or ACS	Depositary of an ICVC, AUT or ACS	Authorised fund manager of an AUT or ACS, or ACD of an ICVC, that is a regulated money market fund
5.2.17AR and 5.2.17BG)					
5.2.17AR and 5.2.17BG	x	x	x		
5.2.20AR		x	x		x
5.2.20BG		x	x		
5.2.21R		x	x		x
5.2.22R	x		x		x
5.2.22AG	x	x	x	x	x
5.2.23R(1)	x	x	x		x
5.2.23R(2) to (4)	x	x	x	x	
COLL 5.2.23-AG	x	x	x		x
5.2.23CR		x	x		
5.2.26R		x	x		
5.2.27R	x				
5.2.28R			x		
5.2.29R	x	x	x		
5.2.30R	x	x	x		x
5.2.31R to 5.2.33R	x	x	x		
5.2.34G		x	x		
Note: x means "applies"					

5.2.2A

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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.

Prudent spread of risk

- 5.2.3 **R**
- (1) An *authorised fund manager* must ensure that, taking account of the investment objectives and policy of the *UCITS scheme* as stated in the most recently published *prospectus*, the *scheme property* of the *UCITS scheme* aims to provide a prudent spread of risk.
 - (2) The *rules* in this section relating to spread of investments do not apply until the expiry of a period of six *months* after the date of which the *authorisation order*, in respect of the *UCITS scheme*, takes effect or on which the *initial offer* commenced, if later, provided that (1) is complied with during such period.

Investment powers: general

- 5.2.4 **R**
- The *scheme property* of each *UCITS scheme* must be invested only in accordance with the relevant provisions in sections ■ COLL 5.2 to ■ COLL 5.5 that are applicable to that *UCITS scheme* and up to any maximum limit so stated, but, the *instrument constituting the fund* may further restrict:
- (1) the kind of property in which the *scheme property* may be invested;
 - (2) the proportion of the *capital property* of the *UCITS scheme* that may be invested in assets of any description;
 - (3) the descriptions of transactions permitted; and
 - (4) the borrowing powers of the *UCITS scheme*.

- 5.2.4A **G**
- Investment powers and limits for *UCITS schemes* that are *regulated money market funds* are set out in the *Money Market Funds Regulation*. Subject to complying with that Regulation, the *instrument constituting the fund* may further restrict:
- the kind of money market instruments in which the *scheme property* may be invested;
 - the proportion of the *capital property* of the *UCITS scheme* to be invested in money market instruments of any description;
 - the descriptions of transactions permitted; and
 - the borrowing powers of the *UCITS scheme*.

Valuation

- 5.2.5 **R**
- (1) In this chapter, the value of the *scheme property* of a *UCITS scheme* means the net value determined in accordance with ■ COLL 6.3 (Valuation and pricing), after deducting any outstanding borrowings, whether immediately due to be repaid or not.
 - (2) When valuing the *scheme property* for the purposes of this chapter:
 - (a) the time as at which the valuation is being carried out ("the relevant time") is treated as if it were a *valuation point*, but the valuation and the relevant time do not count as a valuation or a

valuation point for the purposes of ■ COLL 6.3 (Valuation and pricing);

(b) *initial outlay* is to be regarded as remaining part of the *scheme property*; and

(c) if the *authorised fund manager*, having taken reasonable care, determines that the *UCITS scheme* will become entitled to any unrealised profit which has been made on account of a transaction in *derivatives*, that prospective entitlement is to be regarded as part of the *scheme property*.

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

Valuation guidance

5.2.6

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

UCITS schemes: permitted types of scheme property

5.2.6A

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

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

in accordance with the *rules* in this section.

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

Transferable securities

5.2.7

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- (1) A *transferable security* is an *investment* which is any of the following:
 - (a) a *share*;
 - (b) a *debenture*;
 - (ba) an *alternative debenture*;
 - (c) a *government and public security*;
 - (d) a *warrant*; or
 - (e) a *certificate representing certain securities*.

- (2) An *investment* is not a *transferable security* if the title to it cannot be transferred, or can be transferred only with the consent of a third party.
- (3) In applying (2) to an *investment* which is issued by a *body corporate*, and which is a *share* or a *debenture*, the need for any consent on the part of the *body corporate* or any members or *debenture* holders of it may be ignored.
- (4) An *investment* is not a *transferable security* unless the liability of the holder of it to contribute to the debts of the issuer is limited to any amount for the time being unpaid by the holder of it in respect of the *investment*.

Investment in transferable securities

5.2.7A

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

which is admitted to or *dealt* in on an *eligible* market shall be presumed:

- (a) not to compromise the ability of the *authorised fund manager* to comply with its obligation to *redeem units* at the request of any qualifying *unitholder*; and
- (b) to be negotiable.

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

5.2.7B

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

Closed end funds constituting transferable securities

5.2.7C

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

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

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

5.2.7D

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

- (b) control the investment policy of the closed end fund through appropriate mechanisms.
- (3) The assets of the closed end fund in contractual form should be separate and distinct from those of the asset manager and the closed end fund should be subject to liquidation rules that adequately protect its investors.

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

Transferable securities linked to other assets

5.2.7E

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- (1) A UCITS scheme may invest in any other investment which shall be taken to be a transferable security for the purposes of investment by a UCITS scheme provided the investment:
 - (a) fulfils the criteria for transferable securities set out in ■ COLL 5.2.7A R; and
 - (b) is backed by or linked to the performance of other assets, which may differ from those in which a UCITS scheme can invest.
- (2) Where an investment in (1) contains an embedded derivative component (see ■ COLL 5.2.19R (3A)), the requirements of this section with respect to derivatives and forwards will apply to that component.

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

Approved money-market instruments

5.2.7F

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

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

5.2.7G

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

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

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

5.2.7H

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- (1) A money-market instrument shall be regarded as liquid if it can be sold at limited cost in an adequately short time frame, taking into

account the obligation of the *authorised fund manager* to *redeem units* at the request of any qualifying *unitholder* (see ■ COLL 6.2.16 R (3)).

- (2) A money-market instrument shall be regarded as having a value which can be accurately determined at any time if accurate and reliable valuations systems, which fulfil the following criteria, are available:
 - (a) enabling the *authorised fund manager* to calculate a net asset value in accordance with the value at which the instrument held in the portfolio could be exchanged between knowledgeable willing parties in an arm's length transaction; and
 - (b) based either on market data or on valuation models including systems based on amortised costs.
- (3) A money-market instrument that is normally *dealt* in on the money market and is admitted to or dealt in on an *eligible* market shall be presumed to be liquid and have a value which can be accurately determined at any time unless there is information available to the *authorised fund manager* that would lead to a different determination.

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

Guidance on assessing liquidity and quality of money-market instruments

5.2.7I

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

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

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

5.2.8

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- (1) [deleted]
- (2) [deleted]
- (3) *Transferable securities* and *approved money-market instruments* held within a *UCITS scheme* must be:
 - (a) admitted to or *dealt* in on an *eligible* market within ■ COLL 5.2.10 R (1)(a) (Eligible markets: requirements); or
 - (b) *dealt* in on an *eligible* market within ■ COLL 5.2.10 R (1)(b); or

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

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

Eligible markets regime: purpose

5.2.9

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- (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

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

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

Eligible markets: requirements

5.2.10

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- (1) A market is *eligible* for the purposes of the *rules* in this sourcebook if it is:
 - (a) a *regulated market*;
 - (b) a market in the *United Kingdom* or an *EEA State* which is regulated, operates regularly and is open to the public; or
 - (c) any market within (2).
- (2) A market not falling within (1)(a) and (b) is *eligible* for the purposes of the *rules* in this sourcebook if:
 - (a) the *authorised fund manager*, after consultation with and notification to the *depository* (and in the case of an *ICVC*, any

other *directors*), decides that market is appropriate for investment of, or *dealing in*, the *scheme property*;

- (b) the market is included in a list in the *prospectus*; and
- (c) the *depository* has taken reasonable care to determine that:
 - (i) adequate custody arrangements can be provided for the *investment dealt in* on that market; and
 - (ii) all reasonable steps have been taken by the *authorised fund manager* in deciding whether that market is *eligible*.

- (3) In (2)(a), a market must not be considered appropriate unless it:
 - (a) is regulated;
 - (b) operates regularly;
 - (c) is recognised as a market or exchange or as a self-regulating organisation by an *overseas regulator*;
 - (d) is open to the public;
 - (e) is adequately liquid; and
 - (f) has adequate arrangements for unimpeded transmission of income and capital to or to the order of investors.

Money-market instruments with a regulated issuer

5.2.10A

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

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

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

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

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

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

Issuers and guarantors of money-market instruments

5.2.10B

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

- (a) issued or guaranteed by any one of the following:

- (i) a central authority of the *United Kingdom* or an *EEA State* or, if the *EEA State* is a federal state, one of the members making up the federation;
 - (ii) a regional or local authority of the *United Kingdom* or an *EEA State*;
 - (iii) the Bank of England, the European Central Bank or a central bank of an *EEA State*;
 - (iv) the European Union or the European Investment Bank;
 - (v) a non-*EEA State* or, in the case of a federal state, one of the members making up the federation;
 - (vi) a public international body to which the *United Kingdom* or one or more *EEA States* belong; or
- (b) issued by a body, any *securities* of which are dealt in on an *eligible* market; or
- (c) issued or guaranteed by an establishment which is:
- (i) subject to prudential supervision in accordance with criteria defined by *UK* or *EU* law; or
 - (ii) subject to and complies with prudential rules considered by the *FCA* to be at least as stringent as those laid down by *UK* or *EU* law.
- (2) An establishment shall be considered to satisfy the requirement in (1)(c)(ii) if it is subject to and complies with prudential rules, and fulfils one or more of the following criteria:
- (a) it is located in the *European Economic Area*;
 - (b) it is located in an *OECD* country belonging to the Group of Ten;
 - (c) it has at least investment grade rating;
 - (d) on the basis of an in-depth analysis of the issuer, it can be demonstrated that the prudential rules applicable to that issuer are at least as stringent as those laid down by *UK* or *EU* law.

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

Appropriate information for money-market instruments

5.2.10C

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

- (2) In the case of an *approved money-market instrument* issued or guaranteed by an establishment within ■ COLL 5.2.10BR (1)(c), the following information must be available:
 - (a) information on the issue or the issuance programme or on the legal and financial situation of the issuer prior to the issue of the instrument;
 - (b) updates of that information on a regular basis and whenever a significant event occurs; and
 - (c) available and reliable statistics on the issue or the issuance programme, or other data enabling an appropriate assessment of the credit risks related to investment in those instruments.

- (3) In the case of an *approved money-market instrument*:
 - (a) within ■ COLL 5.2.10BR (1)(a)(i), ■ (iv) or ■ (v); or
 - (b) which is issued by an authority within ■ COLL 5.2.10BR (1)(a)(ii) or a public international body within ■ COLL 5.2.10BR (1)(a)(vi) and is guaranteed by a central authority within ■ COLL 5.2.10BR (1)(a)(i);
 information must be available on the issue or the issuance programme, or on the legal and financial situation of the issuer prior to the issue of the instrument.

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

5.2.10D

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- (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

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- (1) In addition to instruments admitted to or *dealt in* on an *eligible market*, a *UCITS scheme* may also with the express consent of the *FCA* (which takes the form of a *waiver* under sections 138A and 138B of the *Act* as applied by section 250 of the *Act* or regulation 7 of the *OEIC Regulations*) invest in an *approved money-market instrument* provided:
 - (a) the issue or issuer is itself regulated for the purpose of protecting investors and savings in accordance with ■ COLL 5.2.10AR (2);
 - (b) investment in that instrument is subject to investor protection equivalent to that provided by instruments which satisfy the requirements of ■ COLL 5.2.10BR (1)(a), ■ (b) or ■ COLL 5.2.10BR (1)(c); and
 - (c) the issuer is a company whose capital and reserves amount to at least EUR 10 million and which presents and publishes its annual accounts in accordance with the requirements of the *Companies Act 2006* applicable to public companies limited by shares or by

guarantee, or private companies limited by shares or by guarantee, or, for companies incorporated in the *EEA*, Directive 2013/34/EU, is an entity which, within a group of companies which includes one or several listed companies, is dedicated to the financing of the group or is an entity which is dedicated to the financing of securitisation vehicles which benefit from a banking liquidity line.

- (2) A securitisation vehicle is a structure, whether in corporate, trust or contractual form, set up for the purpose of securitisation operations.
- (3) A banking liquidity line is a banking facility secured by a financial institution which is an establishment subject to prudential supervision in accordance with criteria defined by *UK* or *EU* law or an establishment which is subject to and complies with prudential rules considered by the *FCA* (in accordance with ■ COLL 5.2.10BR (2)) to be at least as stringent as those laid down by *UK* or *EU* law.

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

Spread: general

5.2.11

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

- (8) Not more than 20% in value of the *scheme property* is to consist of *transferable securities* and *approved money-market instruments* issued by the same group (as referred to in (2)).
- (9) Not more than 20% in value of the *scheme* is to consist of the *units* of any one *collective investment scheme*.
- (10) In applying the limits in (3),(4),(5), (6) and (7) in relation to a single body, and subject to (5A), not more than 20% in value of the *scheme property* is to consist of any combination of two or more of the following:
 - (a) *transferable securities* (including *covered bonds*) or *approved money-market instruments* issued by that body; or
 - (b) *deposits* made with that body; or
 - (c) exposures from *OTC derivatives* transactions made with that body.
- (11) [deleted]
- (12) [deleted]
- (13) [deleted]
- (14) [deleted]

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

Guidance on spread: general

5.2.11A **G**

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

Counterparty risk and issuer concentration

5.2.11B **R**

- (1) An *authorised fund manager* of a *UCITS scheme* must ensure that *counterparty risk* arising from an *OTC derivative* transaction is subject to the limits set out in ■ COLL 5.2.11R (7) and ■ COLL 5.2.11R (10).
- (2) When calculating the exposure of a *UCITS scheme* to a counterparty in accordance with the limits in ■ COLL 5.2.11R (7), the *authorised fund manager* must use the positive mark-to-market value of the *OTC derivative* contract with that counterparty.
- (3) An *authorised fund manager* may net the *OTC derivative* positions of a *UCITS scheme* with the same counterparty, provided:
 - (a) it is able legally to enforce netting agreements with the counterparty on behalf of the *UCITS scheme*; and

- (b) the netting agreements in (a) do not apply to any other exposures the *UCITS scheme* may have with that same counterparty.
- (4) An *authorised fund manager* of a *UCITS scheme* may reduce the exposure of the *scheme property* to a counterparty to an *OTC derivative* transaction through the receipt of collateral. Collateral received must be sufficiently liquid so that it can be sold quickly at a price that is close to its pre-sale valuation.
- (5) An *authorised fund manager* of a *UCITS scheme* must take collateral into account in calculating exposure to *counterparty risk* in accordance with the limits in ■ COLL 5.2.11BR (7) when it passes collateral to the counterparty to an *OTC derivative* transaction on behalf of the *UCITS scheme*.
- (6) Collateral passed in accordance with (5) may be taken into account on a net basis only if the *authorised fund manager* is able legally to enforce netting arrangements with this counterparty on behalf of the *UCITS scheme*.
- (7) An *authorised fund manager* of a *UCITS scheme* must calculate the issuer concentration limits referred to in ■ COLL 5.2.11 R on the basis of the underlying exposure created through the use of *OTC derivatives* in accordance with the commitment approach.
- (8) In relation to exposures arising from *OTC derivative* transactions, as referred to in ■ COLL 5.2.11R (10), the *authorised fund manager* must include in the calculation any *counterparty risk* relating to the *OTC derivative* transactions.

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

Spread: government and public securities

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) the *United Kingdom* or an *EEA State*;
 - (b) a local authority of the *United Kingdom* or an *EEA State*;
 - (c) a non-*EEA State*; or
 - (d) a public international body to which the *UK* or one or more *EEA States* belong.
- (2) Where no more than 35% in value of the *scheme property* is invested in such *securities* issued by any one body, there is no limit on the amount which may be invested in such *securities* or in any one issue.
- (3) An *authorised fund* may invest more than 35% in value of the *scheme property* in such *securities* issued by any one body provided that:
 - (a) the *authorised fund manager* has before any such investment is made consulted with the *depository* and as a result considers that the issuer of such *securities* is one which is appropriate in accordance with the investment objectives of the *authorised fund*;

- (b) no more than 30% in value of the *scheme property* consists of such *securities* of any one issue;
 - (c) the *scheme property* includes such *securities* issued by that or another issuer, of at least six different issues; and
 - (d) the disclosures in ■ COLL 3.2.6R(8) (Table: contents of the instrument constituting the fund) and ■ COLL 4.2.5R(3)(i) (Table: contents of the prospectus) have been made.
- (4) [deleted]
- (5) In this *rule* in relation to such *securities*:
- (a) issue, issued and issuer include guarantee, guaranteed and guarantor; and
 - (b) an issue differs from another if there is a difference as to repayment date, rate of interest, guarantor or other material terms of the issue.
- (6) Notwithstanding ■ COLL 5.2.11R (1) and subject to ■ (2) and ■ (3), in applying the 20% limit in ■ COLL 5.2.11R (10) with respect to a single body, such *securities* issued by that body shall be taken into account.

Investment in collective investment schemes

5.2.13

R

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

- (1) the second *scheme* must:
 - (a) be a *UCITS scheme* or satisfy the conditions necessary for it to enjoy the rights conferred by the *UCITS Directive* as implemented in the *EEA*; or
 - (b) be a *recognised scheme* that is authorised by the *supervisory authorities* of Guernsey, Jersey or the Isle of Man (provided the requirements of ■ COLL 5.2.13AR are met); or
 - (c) be authorised as a *non-UCITS retail scheme* (provided the requirements of ■ COLL 5.2.13AR(1), (3) and (4) are met); or
 - (d) be authorised in an *EEA State* (provided the requirements of ■ COLL 5.2.13AR are met); or
 - (e) be authorised by the competent authority of an *OECD* member country (other than an *EEA State*) which has:
 - (i) signed the IOSCO Multilateral Memorandum of Understanding; and
 - (ii) approved the *scheme's* management company, rules and *depository/custody* arrangements;
 (provided the requirements of ■ COLL 5.2.13AR are met);
- (2) the second *scheme* must comply, where relevant, with ■ COLL 5.2.15 R (Investment in associated collective investment schemes) and ■ COLL 5.2.16 R (Investment in other group schemes);

- (3) the second *scheme* must have terms which prohibit more than 10% in value of the *scheme property* consisting of *units* in *collective investment schemes*; and
- (4) where the second *scheme* is an *umbrella*, the provisions in (2) and (3) and ■ COLL 5.2.11 R (Spread: general) apply to each *sub-fund* as if it were a separate *scheme*.

5.2.13A

R

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

- (1) the second *scheme* is an undertaking:
 - (a) with the sole object of collective investment in *transferable securities* or in other liquid financial assets, as referred to in this chapter, of capital raised from the public and which operate on the principle of risk-spreading; and
 - (b) with *units* which are, at the request of holders, repurchased or *redeemed*, directly or indirectly, out of those undertakings' assets (action taken by a *scheme* to ensure that the price of its *units* on an investment exchange does not significantly vary from their net asset value shall be regarded as equivalent to such repurchase or *redemption*);
- (2) the second *scheme* is authorised under laws which provide that they are subject to supervision considered by the *FCA* to be equivalent to that laid down in the law of the *United Kingdom*, and that cooperation between the *FCA* and the *supervisory authorities* of the second *scheme* is sufficiently ensured;
- (3) the level of protection for *unitholders* in the second *scheme* is equivalent to that provided for *unitholders* in a *UCITS scheme*, and in particular that the rules on asset segregation, borrowing, lending, and uncovered sales of *transferable securities* and *approved money market instruments* are equivalent to the requirements of this chapter; and
- (4) the business of the second *scheme* is reported in half-yearly and annual reports to enable an assessment to be made of the assets and liabilities, income and operations over the reporting period.

Qualifying non-UCITS collective investment schemes

5.2.14

G

- (1) ■ COLL 9.3 gives further detail as to the recognition of a *scheme* under section 272 of the *Act*.
- (2) A *scheme* which has the power to invest in gold or immovables would not meet the criteria set out in ■ COLL 5.2.13R (1).
- (3) In determining whether a *scheme* (other than a *UCITS*) meets the requirements of ■ COLL 5.2.13AR for the purposes of ■ COLL 5.2.13R (1), the *authorised fund manager* should consider the following factors before deciding that the *scheme* provides a level of protection for *unitholders* which is equivalent to that provided to *unitholders* in a *UCITS scheme*:
 - (a) the rules guaranteeing the autonomy of the *scheme* and management in the exclusive interest of the *unitholders*;

- (b) the existence of an independent *depository/custodian* with similar duties and responsibilities in relation to both safekeeping and supervision; where an independent *depository/custodian* is not a requirement of local law as regards *collective investment schemes*, robust governance structures may provide a suitable alternative;
- (c) the availability of pricing information and reporting requirements;
- (d) redemption facilities and frequency;
- (e) restrictions in relation to dealings by related parties;
- (f) the extent of asset segregation; and
- (g) the local requirements for borrowing, lending and uncovered sales of *transferable securities* and money market instruments regarding the portfolio of the *scheme*.

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

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

Investment in associated collective investment schemes

5.2.15

R

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

Investment in other group schemes

5.2.16

R

- (1) Where:
 - (a) an investment or disposal is made under ■ COLL 5.2.15 R; and
 - (b) there is a charge in respect of such investment or disposal;
 the *authorised fund manager* of the *UCITS scheme* making the investment or disposal must pay the *UCITS scheme* the amounts referred to in (2) or (3) within four *business days* following the date of the agreement to invest or dispose.
- (2) When an investment is made, the amount referred to in (1) is either:
 - (a) any amount by which the consideration paid by the *UCITS scheme* for the *units* in the second *scheme* exceeds the price that would have been paid for the benefit of the second *scheme* had the *units* been newly issued or sold by it; or
 - (b) if such price cannot be ascertained by the *authorised fund manager* of the *authorised fund*, the maximum amount of any charge permitted to be made by the seller of *units* in the second *scheme*.
- (3) When a disposal is made, the amount referred to in (1) is any charge made for the account of the *authorised fund manager* or *operator* of the second *scheme* or an *associate* of any of them in respect of the disposal.
- (4) In this *rule*:
 - (a) any addition to or deduction from the consideration paid on the acquisition or disposal of *units* in the second *scheme*, which is applied for the benefit of the second *scheme* and is, or is like, a *dilution levy* made in accordance with ■ COLL 6.3.8 R (Dilution) is to be treated as part of the *price* of the *units* and not as part of any charge; and
 - (b) any charge made in respect of an exchange of *units* in one *sub-fund* or separate part of the second *scheme* for *units* in another *sub-fund* or separate part of that *scheme* is to be included as part of the consideration paid for the *units*.

Investment in nil and partly paid securities

5.2.17

R

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

Investment in securitisation positions

5.2.17A

R

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

5.2.17B G Article 5 (Due diligence requirements for institutional investors) of the *Securitisation Regulation* applies to *authorised fund managers* in combination with ■ COLL 5.2.17AR.

5.2.18 R [deleted]

Derivatives: general.....

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

[Note: article 10 of the *UCITS eligible assets Directive*]

- (4) Where a *scheme* invests in an index based *derivative*, provided the relevant index falls within ■ COLL 5.2.20AR (Financial indices underlying derivatives) the underlying constituents of the index do not have to be taken into account for the purposes of ■ COLL 5.2.11 R and ■ COLL 5.2.12 R.
- (5) The relaxation in (4) is subject to the *authorised fund manager* taking account of ■ COLL 5.2.3 R (Prudent spread of risk).

Guidance on transferable securities and money-market instruments embedding derivatives

5

5.2.19A

G

- (1) Collateralised debt obligations (CDOs) or asset-backed securities using *derivatives*, with or without an active management, will generally not be considered as embedding a *derivative* except if:
 - (a) they are leveraged, i.e. the CDOs or asset-backed securities are not limited recourse vehicles and the investors' loss can be higher than their initial investment; or
 - (b) they are not sufficiently diversified.
- (2) Where a *transferable security* or *approved money-market instrument* embedding a *derivative* is structured as an alternative to an *OTC derivative*, the requirements set out in ■ COLL 5.2.23 R with respect to transactions in *OTC derivatives* will apply. This will be the case for tailor-made hybrid instruments, such as a single tranche CDO structured to meet the specific need of a *scheme*, which should be considered as embedding a *derivative*. Such a product offers an alternative to the use of an *OTC derivative*, for the same purpose of achieving a diversified exposure with a pre-set credit risk level to a portfolio of entities.
- (3) The following list of *transferable securities* and *approved money-market instruments*, which is illustrative and non-exhaustive, could be assumed to embed a *derivative*:
 - (a) credit linked notes;
 - (b) *transferable securities* or *approved money-market instruments* whose performance is linked to the performance of a bond index;
 - (c) *transferable securities* or *approved money-market instruments* whose performance is linked to the performance of a basket of shares, with or without active management;
 - (d) *transferable securities* or *approved money-market instruments* with a fully guaranteed nominal value whose performance is linked to the performance of a basket of shares, with or without active management;
 - (e) convertible bonds; and
 - (f) exchangeable bonds.
- (4) *Schemes* cannot use *transferable securities* or *approved money-market instruments* which embed a *derivative* to circumvent the rules in this section.
- (5) *Transferable securities* and *approved money-market instruments* which embed a *derivative* are subject to the rules applicable to

derivatives as required by this section. It is the *authorised fund manager's* responsibility to check that these requirements are complied with. The nature, frequency and scope of checks performed will depend on the characteristics of the embedded *derivatives* and on their impact on the *scheme*, taking into account its stated investment objective and risk profile.

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

Permitted transactions (derivatives and forwards)

5.2.20

R

- (1) A transaction in a *derivative* must:
 - (a) be in an *approved derivative*; or
 - (b) be one which complies with ■ COLL 5.2.23 R (OTC transactions in derivatives).

- (2) The underlying of a transaction in a *derivative* must consist of any one or more of the following to which the *scheme* is *dedicated*:
 - (a) *transferable securities* permitted under ■ COLL 5.2.8 R (3)(a) to ■ (c) and ■ COLL 5.2.8 R (3)(e);
 - (b) *approved money-market instruments* permitted under ■ COLL 5.2.8 R (3)(a) to ■ COLL 5.2.8 R (3)(d);
 - (c) *deposits* permitted under ■ COLL 5.2.26 R (Investment in deposits);
 - (d) *derivatives* permitted under this *rule*;
 - (e) *collective investment scheme* units permitted under ■ COLL 5.2.13 R (Investment in collective investment schemes);
 - (f) financial indices which satisfy the criteria set out in ■ COLL 5.2.20A R;
 - (g) interest rates;
 - (h) foreign exchange rates; and
 - (i) currencies.

[**Note:** article 8(1)(a) of the *UCITS eligible assets Directive*]

- (3) A transaction in an *approved derivative* must be effected on or under the rules of an *eligible derivatives* market.

- (4) A transaction in a *derivative* must not cause a *scheme* to diverge from its investment objectives as stated in the *instrument constituting the fund* and the most recently published *prospectus*.

- (5) A transaction in a *derivative* must not be entered into if the intended effect is to create the potential for an uncovered sale of one or more *transferable securities, approved money-market instruments, units in collective investment schemes* or *derivatives* provided that a sale is not to be considered as uncovered if the conditions in ■ COLL 5.2.22R (1) (Requirement to cover sales), as read in accordance with the guidance at ■ COLL 5.2.22A G, are satisfied.

- (6) Any forward transaction must be made with an *eligible institution* or an *approved bank*.

- (7) A *derivative* includes an instrument which fulfils the following criteria:
- (a) it allows the transfer of the credit risk of the underlying independently from the other risks associated with that underlying;
 - (b) it does not result in the delivery or the transfer of assets other than those referred to in ■ COLL 5.2.6A R (UCITS schemes: permitted types of scheme property) including cash;
 - (c) in the case of an *OTC derivative*, it complies with the requirements in ■ COLL 5.2.23 R (OTC transactions in derivatives);
 - (d) its risks are adequately captured by the risk management process of the *authorised fund manager*, and by its internal control mechanisms in the case of risks of asymmetry of information between the *authorised fund manager* and the counterparty to the *derivative*, resulting from potential access of the counterparty to non-public information on *persons* whose assets are used as the underlying by that *derivative*.

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

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

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

Financial indices underlying derivatives

5.2.20A

R

- (1) The financial indices referred to in ■ COLL 5.2.20R (2)(f) are those which satisfy the following criteria:
- (a) the index is sufficiently diversified;
 - (b) the index represents an adequate benchmark for the market to which it refers; and
 - (c) the index is published in an appropriate manner.
- (2) A financial index is sufficiently diversified if:
- (a) it is composed in such a way that price movements or trading activities regarding one component do not unduly influence the performance of the whole index;
 - (b) where it is composed of assets in which a *UCITS scheme* is permitted to invest, its composition is at least diversified in accordance with the requirements with respect to spread and concentration set out in this section; and
 - (c) where it is composed of assets in which a *UCITS scheme* cannot invest, it is diversified in a way which is equivalent to the diversification achieved by the requirements with respect to spread and concentration set out in this section.
- (3) A financial index represents an adequate benchmark for the market to which it refers if:
- (a) it measures the performance of a representative group of underlyings in a relevant and appropriate way;

- (b) it is revised or rebalanced periodically to ensure that it continues to reflect the markets to which it refers, following criteria which are publicly available; and
 - (c) the underlyings are sufficiently liquid, allowing users to replicate it if necessary.
- (4) A financial index is published in an appropriate manner if:
- (a) its publication process relies on sound procedures to collect prices, and calculate and subsequently publish the index value, including pricing procedures for components where a market price is not available; and
 - (b) material information on matters such as index calculation, rebalancing methodologies, index changes or any operational difficulties in providing timely or accurate information is provided on a wide and timely basis.
- (5) Where the composition of underlyings of a transaction in a *derivative* does not satisfy the requirements for a financial index, the underlyings for that transaction shall where they satisfy the requirements with respect to other underlyings pursuant to ■ COLL 5.2.20R (2), be regarded as a combination of those underlyings.

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

Guidance on financial indices underlying derivatives

5.2.20B

G

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

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

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

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

(4) [deleted]

Transactions for the purchase of property

5.2.21

R

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

- (1) that property can be held for the account of the *UCITS scheme*; and
- (2) the *authorised fund manager* having taken reasonable care determines that delivery of the property under the transaction will not occur or will not lead to a breach of the *rules* in this sourcebook.

Requirement to cover sales

5.2.22

R

(1) No agreement by or on behalf of a *UCITS scheme* to dispose of property or rights may be made unless:

- (a) the obligation to make the disposal and any other similar obligation could immediately be honoured by the *UCITS scheme* by delivery of property or the assignment (or, in Scotland, assignation) of rights; and
- (b) the property and rights at (a) are owned by the *UCITS scheme* at the time of the agreement.

(2) Paragraph (1) does not apply to a *deposit*.

(3) [deleted]

(4) [deleted]

Guidance on requirement to cover sales

5.2.22A

G

[deleted]

(1) In the *FCA's* view the requirement in ■ **COLL 5.2.22R (1)(a)** can be met where:

- (a) the risks of the underlying financial instrument of a *derivative* can be appropriately represented by another financial instrument and the underlying financial instrument is highly liquid; or
- (b) the *authorised fund manager* or the *depository* has the right to settle the *derivative* in cash, and cover exists within the *scheme property* which falls within one of the following asset classes:
 - (i) cash;
 - (ii) liquid debt instruments (e.g. government bonds of first credit rating) with appropriate safeguards (in particular, haircuts); or

(iii) other highly liquid assets having regard to their correlation with the underlying of the financial *derivative* instruments, subject to appropriate safeguards (e.g. haircuts where relevant).

(2) In the asset classes referred to in (1), an asset may be considered as liquid where the instrument can be converted into cash in no more than seven *business days* at a price closely corresponding to the current valuation of the financial instrument on its own market.

OTC transactions in derivatives

5.2.23

R

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

- (1) with an approved counterparty; a counterparty to a transaction in *derivatives* is approved only if the counterparty is:
 - (a) an *eligible institution* or an *approved bank*;
 - (b) a *person* whose *permission* (including any *requirements* or *limitations*), as published in the *Financial Services Register*, permits it to enter into the transaction as *principal off-exchange*;
 - (c) a *CCP* that is authorised in that capacity for the purposes of *EMIR*;
 - (d) a *CCP* that is recognised in that capacity in accordance with the process set out in article 25 of *EMIR*; or
 - (e) to the extent not already covered above, a *CCP* supervised in a jurisdiction that:
 - (i) has implemented the relevant G20 reforms on over-the-counter derivatives to at least the same extent as the *United Kingdom*; and
 - (ii) is identified as having done so by the Financial Stability Board in its summary report on progress in implementation of G20 financial regulatory reforms dated 25 June 2019;
- (2) on approved terms; the terms of the transaction in *derivatives* are approved only if the *authorised fund manager*:
 - (a) carries out, at least daily, a reliable and verifiable valuation in respect of that transaction corresponding to its fair value and which does not rely only on market quotations by the counterparty; and
 - (b) can enter into one or more further transactions to *sell*, liquidate or *close out* that transactions at any time, at its fair value ;
- (3) capable of reliable valuation; a transaction in *derivatives* is capable of reliable valuation only if the *authorised fund manager* having taken reasonable care determines that, throughout the life of the *derivative* (if the transaction is entered into), it will be able to value the *investment* concerned with reasonable accuracy:
 - (a) on the basis of an up-to-date market value which the *authorised fund manager* and the *depository* have agreed is reliable; or
 - (b) if the value referred to in (a) is not available, on the basis of a pricing model which the *authorised fund manager* and the

5

depository have agreed uses an adequate recognised methodology; and

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

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

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

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

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

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

Valuation of OTC derivatives

- 5.2.23C **R**
- (1) For the purposes of ■ COLL 5.2.23 R (2), an *authorised fund manager* of a *UCITS scheme* must:
 - (a) establish, implement and maintain arrangements and procedures which ensure appropriate, transparent and fair valuation of the exposures of a *UCITS scheme* to *OTC derivatives*; and
 - (b) ensure that the fair value of *OTC derivatives* is subject to adequate, accurate and independent assessment.
 - (2) Where the arrangements and procedures referred to in (1) involve the performance of certain activities by third parties, the *authorised fund manager* must comply with the requirements in ■ SYSC 8.1.13 R (Additional requirements for a management company) and ■ COLL 6.6A.4 R (5) and ■ (6) (Due diligence requirements of AFMs of UCITS schemes).
 - (3) The arrangements and procedures referred to in this *rule* must be:

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

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

5.2.24 **R**

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

5.2.25 **G**

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

Investment in deposits

5.2.26 **R**

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

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

Significant influence for ICVCs

5.2.27 **R**

- (1) An *ICVC* must not acquire *transferable securities* issued by a *body corporate* and carrying rights to vote (whether or not on substantially all matters) at a general meeting of that *body corporate* if:
 - (a) immediately before the acquisition, the aggregate of any such *securities* held by the *ICVC* gives the *ICVC* power to influence significantly the conduct of business of that *body corporate*; or
 - (b) the acquisition gives the *ICVC* that power.
- (2) For the purpose of (1), an *ICVC* is to be taken to have power significantly to influence the conduct of business of a *body corporate*

if it can, because of the *transferable securities* held by it, exercise or control the exercise of 20% or more of the voting rights in that *body corporate* (disregarding for this purpose any temporary suspension of voting rights in respect of the *transferable securities* of that *body corporate*).

Significant influence for authorised fund managers of AUTs or ACSs

5.2.28

R

- (1) An *authorised fund manager* must not acquire, or cause to be acquired for an AUT or ACS of which it is the *authorised fund manager*, *transferable securities* issued by a *body corporate* and carrying rights to vote (whether or not on substantially all matters) at a general meeting of the *body corporate* if:
 - (a) immediately before the acquisition, the aggregate of any such *securities* held for that AUT or ACS, taken together with any such *securities* already held for other AUTs or 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

5.2.29

R

A UCITS scheme:

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

UCITS schemes that are umbrellas

5.2.30

R

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

R

- (1) Notwithstanding ■ COLL 5.2.11 R (Spread: general), a *UCITS scheme* may invest up to 20% in value of the *scheme property* in *shares* and *debentures* which are issued by the same body where the investment policy of that *scheme* as stated in the most recently published *prospectus* is to replicate the composition of a relevant index which satisfies the criteria specified in ■ COLL 5.2.33 R (Relevant indices).
- (1A) Replication of the composition of a relevant index shall be understood to be a reference to replication of the composition of the underlying assets of that index, including the use of techniques and instruments permitted for the purpose of *efficient portfolio management*.

[Note: article 12(1) of the *UCITS eligible assets Directive*]
- (2) The limit in (1) can be raised for a particular *UCITS scheme* up to 35% in value of the *scheme property*, but only in respect of one body and where justified by exceptional market conditions.

Index replication

5.2.32

G

- (1) [deleted]
- (2) In the case of a *UCITS scheme* replicating an index under ■ COLL 5.2.31 R (Schemes replicating an index) the *scheme property* need not consist of the exact composition and weighting of the underlying in the relevant index in cases where the *scheme's*

investment objective is to achieve a result consistent with the replication of an index rather than an exact replication.

Relevant indices

5.2.33

R

- (1) The indices referred to in ■ COLL 5.2.31 R are those which satisfy the following criteria:
 - (a) the composition is sufficiently diversified;
 - (b) the index represents an adequate benchmark for the market to which it refers; and
 - (c) the index is published in an appropriate manner.
- (2) The composition of an index is sufficiently diversified if its components adhere to the spread and concentration requirements in this section.
- (3) An index represents an adequate benchmark if its provider uses a recognised methodology which generally does not result in the exclusion of a major issuer of the market to which it refers.
- (4) An index is published in an appropriate manner if:
 - (a) it is accessible to the public;
 - (b) the index provider is independent from the index-replicating *UCITS scheme*; this does not preclude index providers and the *UCITS scheme* from forming part of the same *group*, provided that effective arrangements for the management of conflicts of interest are in place.

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

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

5.2.34

G

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

Guidance on syndicated loans

5.2.35

G

- (1) A syndicated loan for the purposes of this *guidance* means a form of loan where a group or syndicate of parties lend *money* to a third party and, in return, receive interest payments during the life of the debt and a return of principal either at the end of the loan period or amortised over the life of the loan. Such loans are usually arranged through agent banks which may, among other things, maintain a record of the lenders' interest in the loan and arrange or act as a conduit for the interest payments. Whether an interest in a syndicated loan constitutes a *transferable security* or otherwise will depend on the terms of the relevant instrument. Where an *authorised fund manager* plans to invest *scheme property* in interests in such syndicated loans, it may wish to consider seeking professional advice as to their eligibility.
- (2) To determine whether an interest in a syndicated loan would be an eligible investment for a *UCITS scheme* in accordance with ■ COLL 5.2, an *authorised fund manager* should first consider whether it constitutes a *transferable security* within the meaning of ■ COLL 5.2.7 R (Transferable securities) and ■ COLL 5.2.7AR (which implemented the additional eligibility criteria arising out of the *UCITS eligible assets Directive* that relate to liquidity, valuations and negotiability).
- (3) A *UCITS scheme* cannot lend money from its *scheme property*. Accordingly, it is unable to partake in the initial funding of a syndicated loan either as an original lender or as a person who becomes a lender as part of the primary syndication of the loan. However, we recognise that a *UCITS scheme* may be acknowledged as the lender of record as a consequence of the legal form of transfer used to purchase a loan in the secondary market, such as novation.
- (4) An instrument will not be a *transferable security* if it falls within one or more of the exclusions set out in article 77(2) of the *Regulated Activities Order*. An instrument acknowledging or creating indebtedness for, or for money borrowed to defray, the consideration payable under a contract for the supply of goods or services would be an example of an exclusion.
- (5) In the *FCA's* opinion, for an instrument to be classed as a *debenture* for the purposes of constituting a *transferable security* (see ■ COLL 5.2.7 R (1)(b)), there must be an instrument creating or evidencing indebtedness. A facilities agreement and a drawdown request which does not create or evidence indebtedness will not be a *debenture* for these purposes.
- (6) In the *FCA's* view, the simple fact that a debt obligation is legally transferable (whether by way of creation, assignment or otherwise) does not necessarily make it negotiable for the purposes of ■ COLL 5.2.7AR (1)(e) (Investment in transferable securities), so as to make it a permissible investment for a *UCITS scheme*. When *securities* are capable of being traded on a capital market, whether *on-exchange* or *off-exchange*, as a class and are fungible within their class, this would tend to indicate (unless the *AFM* was aware of specific evidence to the contrary) that they are negotiable.
- (7) The *FCA's* understanding is that leveraged loans are a non-investment grade sub-set of syndicated loans and, where this is the case, *AFMs*

should use similar analysis to determine whether or not interests in such loans are eligible investments for *UCITS schemes*.

- (8) Where a loan falls within the *Glossary* definition of a *transferable security*, investment in such a loan in the case of a *UCITS scheme* is subject to the spread requirements in ■ COLL 5.2.11 R (Spread: general). *AFMs* also need to bear in mind that where such a *transferable security* does not meet the requirements of ■ COLL 5.2.8 R (3) (Transferable securities and money-market instruments generally to be admitted to or dealt in on an eligible market), the *scheme's* overall exposure to such loans will count towards the limit in ■ COLL 5.2.8 R (4).

ESMA guidelines

5.2.36

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

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

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

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

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

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

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