Chapter 5

Investment and borrowing powers
5.2 General investment powers and limits for UCITS schemes

Application

5.2.1 (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

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

Prudent spread of risk

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

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

**5.2.4**

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

1. the kind of property in which the *scheme property* may be invested;
2. the proportion of the *capital property* of the *UCITS scheme* 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.
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).

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]

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.
Closed end funds constituting transferable securities

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]

Transferable securities linked to other assets

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 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 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 (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 5.2.10 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 (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]

Eligible markets: requirements

5.2.10 (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]
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]
Spread: general

5.2.11 R

(1) This rule does not apply in respect of a transferable security or an approved money-market instrument to which COLL 5.2.12R (Spread: government and public securities) applies.

(2) For the purposes of this rule companies included in the same group for the purposes of consolidated accounts as defined in accordance with 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]**

### Guidance on spread: general

5.2.11A  

(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

5.2.11B  

(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 5.2.11R 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.
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) satisfy the conditions necessary for it to enjoy the rights conferred by the UCITS Directive; or
   (b) 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
   (c) be authorised as a non-UCITS retail scheme (provided the requirements of article 50(1)(e) of the UCITS Directive are met); or
   (d) be authorised in another EEA State (provided the requirements of article 50(1)(e) of the UCITS Directive are met); or
   (e) be authorised by the competent authority of an OECD member country (other than another EEA State) which has:
      (i) signed the IOSCO Multilateral Memorandum of Understanding; and
      (ii) approved the scheme’s management company, rules and depositary/custody arrangements;

(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 G

(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 5.2.13 R (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
(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 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 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 [deleted]

**Derivatives: general**

5.2.19 (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 5.2.20 AR (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)

5.2.20

(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

(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 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]
5.222A

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.

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; 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

(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

(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

(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

5.2.36

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)


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).