

## Chapter 5

# Investment and borrowing powers

## 5.4 Stock lending

### Application

- 5.4.1 **R** (1) Subject to (2), this section applies to an *ICVC*, the *depository* of an *authorised fund* and an *authorised fund manager* in any case where the *authorised fund* is a *UCITS scheme* or a *non-UCITS retail scheme*.
- (2) This section does not apply in any case where a *UCITS scheme* or a *non-UCITS retail scheme* is a *regulated money market fund*. The *Money Market Funds Regulation* sets out restrictions in relation to *stock lending* and *repo* contracts that apply in relation to *regulated money market funds*.
- 5.4.1A **G** ■ COLL 6.6B sets out additional *FCA rules* applicable to a *depository* of a *UCITS scheme* in relation to the re-use of *UCITS custodial assets*.

### Permitted stock lending

- 5.4.2 **G** (1) This section covers techniques relating to *transferable securities* and *approved money-market instruments* which are used for the purpose of *efficient portfolio management*. It permits the generation of additional income for the benefit of the *authorised fund*, and hence for its investors, by entry into *stock lending* transactions for the account of the *authorised fund*.
- (2) The specific method of *stock lending* permitted in this section is in fact not a transaction which is a loan in the normal sense. Rather it is an arrangement of the kind described in section 263B of the Taxation of Chargeable Gains Act 1992, under which the lender transfers *securities* to the borrower otherwise than by way of *sale* and the borrower is to transfer those *securities*, or *securities* of the same type and amount, back to the lender at a later date. In accordance with good market practice, a separate transaction by way of transfer of assets is also involved for the purpose of providing *collateral* to the "lender" to cover him against the risk that the future transfer back of the *securities* may not be satisfactorily completed.

### Stock lending: general

- 5.4.3 **R** (1) An *authorised fund* may only enter into a *stock lending* arrangement or *repo* contract in accordance with the *rules* in this section if the arrangement or contract is:
- (a) for the account of and for the benefit of the *scheme*; and

(b) in the interests of its *unitholders*.

(2) An arrangement or contract in (1) is not in the interests of *unitholders* unless it reasonably appears to the *ICVC* or *authorised fund manager* of an *authorised fund* to be appropriate with a view to generating additional income for the *authorised fund* with an acceptable degree of risk.

**Stock lending: requirements**

5.4.4

**R**

(1) An *ICVC*, or the *depository* of an *authorised fund* acting in accordance with the instructions of the *authorised fund manager*, may enter into a *repo* contract, or a *stock lending* arrangement of the kind described in section 263B of the Taxation of Chargeable Gains Act 1992 (without extension by section 263C), but only if:

(a) all the terms of the agreement under which *securities* are to be reacquired by the *depository* for the account of the *ICVC*, *AUT* or *ACS* are in a form which is acceptable to the *depository* and are in accordance with good market practice;

(b) the counterparty is:

(i) an *authorised person*; or

(ii) a *person* authorised by a *Home State regulator*; or

(iii) a *person* registered as a broker-dealer with the Securities and Exchange Commission of the United States of America; or

(iv) a bank, or a branch of a bank, supervised and authorised to deal in investments as principal, with respect to *OTC derivatives* by at least one of the following federal banking supervisory authorities of the United States of America:

(A) the Office of the Comptroller of the Currency;

(B) the Federal Deposit Insurance Corporation; and

(C) the Board of Governors of the Federal Reserve System; and

(D) [deleted]

(c) high quality and liquid *collateral* is obtained to secure the obligation of the counterparty under the terms referred to in (a) and the *collateral* is:

(i) acceptable to the *depository*;

(ii) adequate; and

(iii) sufficiently immediate.

(2) The counterparty for the purpose of (1) is the *person* who is obliged under the agreement referred to in (1)(a) to transfer to the *depository* the *securities* transferred by the *depository* under the *stock lending* arrangement or *securities* of the same kind.

(3) (1)(c) does not apply to a *stock lending* transaction made through Euroclear Bank SA/NV's Securities Lending and Borrowing Programme.

**Stock lending: treatment of collateral**

5.4.5

**G**

Where a *stock lending* arrangement is entered into, the *scheme property* remains unchanged in terms of value. The *securities* transferred cease to be part of the *scheme property*, but there is obtained in return an obligation on the part of the counterparty to transfer back equivalent *securities*. The *depository* will also receive *collateral* to set against the risk of default in transfer, and that *collateral* is equally irrelevant to the valuation of the *scheme property* (because it is transferred against an obligation of equivalent value by way of re-transfer). ■ COLL 5.4.6 R accordingly makes provision for the treatment of the *collateral* in that context.

**Treatment of collateral**

5.4.6

**R**

- (1) *Collateral* is adequate for the purposes of this section only if it is:
- (a) transferred to the *depository* or its agent;
  - (aa) for a *UCITS scheme*, received under a title transfer arrangement;
  - (ab) for a *UCITS scheme*, at all times equal in value to the market value of the *securities* transferred by the *depository* plus a premium;
  - (b) for a *non-UCITS retail scheme*, at all times at least equal in value to the value of the *securities* transferred by the *depository*; and
  - (c) for a *non-UCITS retail scheme*, in the form of one or more of:
    - (i) cash; or
    - (ii) [deleted]
    - (iii) a certificate of *deposit*; or
    - (iv) a letter of *credit*; or
    - (v) a *readily realisable security*; or
    - (vi) commercial paper with no embedded *derivative* content; or
    - (vii) a *qualifying money market fund*.
- (1A) Where the *collateral* is invested in *units* in a *qualifying money market fund* managed or operated by (or, for an *ICVC*, whose *ACD* is) the *authorised fund manager* of the investing *scheme* or an *associate* of that *authorised fund manager*, the conditions in ■ COLL 5.2.16 R (Investment in other group schemes) must be complied with whether or not the investing *scheme* is a *UCITS scheme* or a *non-UCITS retail scheme*.
- (2) *Collateral* is sufficiently immediate for the purposes of this section if:
- (a) it is transferred before or at the time of the transfer of the *securities* by the *depository*; or
  - (b) the *depository* takes reasonable care to determine at the time referred to in (a) that it will be transferred at the latest by the close of business on the *day* of the transfer.
- (3) The *depository* must ensure that the value of the *collateral* at all times meets the requirement of either (1)(ab) or (1)(b), as appropriate.

- (4) The duty in (3) may be regarded as satisfied in respect of *collateral* the validity of which is about to expire or has expired where the *depository* takes reasonable care to determine that sufficient *collateral* will again be transferred at the latest by the close of business on the *day* of expiry.
- (5) Any agreement for transfer at a future date of *securities* or of *collateral* (or of the equivalent of either) under this section may be regarded, for the purposes of valuation under ■ COLL 6.3 (Valuation and pricing) or this chapter, as an unconditional agreement for the *sale* or transfer of property, whether or not the property is part of the property of the *authorised fund*.
- (6) *Collateral* transferred to the *depository* is part of the *scheme property* for the purposes of the *rules* in this sourcebook, except in the following respects:
  - (a) it does not fall to be included in any valuation for the purposes of ■ COLL 6.3 or this chapter, because it is offset under (5) by an obligation to transfer; and
  - (b) it does not count as *scheme property* for any purpose of this chapter other than this section.
- (7) Paragraph (5) and (6)(a) do not apply to any valuation of *collateral* itself for the purposes of this section.

5.4.6A

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As regards the *collateral* adequacy of a *UCITS scheme* and restrictions on *collateral* that take the form of cash for a *UCITS scheme*, *authorised fund managers* are referred to paragraph 43 of the *ESMA Guidelines* to competent authorities and *UCITS* management companies on *ETFs* and other *UCITS* issues (ESMA 2012/832)

[https://www.esma.europa.eu/sites/default/files/library/2015/11/2012-832en\\_guidelines\\_on\\_etfs\\_and\\_other\\_ucits\\_issues.pdf](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](https://www.esma.europa.eu/sites/default/files/library/2015/11/2014-294_final_report_revision_of_guidelines_etfs_and_other_ucits_issues.pdf)

**Limitation by value**

5.4.7

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There is no limit on the value of the *scheme property* which may be the subject of *repo* contracts or *stock lending* transactions within this section.

**Guidance relating to the use of cash collateral**

5.4.8

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- (1) The use of *stock lending* or the reinvestment of cash collateral should not result in a change of the *scheme's* declared investment objectives or add substantial supplementary risks to the *scheme's* risk profile.
- (2) Collateral taking the form of cash may only be invested in:
  - (a) one of the investments coming within ■ COLL 5.4.6 R (1) (c) (iii) to ■ (vii) (Treatment of collateral); or
  - (b) *deposits*, provided they:

- (i) are capable of being withdrawn within five *business days*, or such shorter time as may be dictated by the *stock lending* agreement; and
- (ii) satisfy the requirements of ■ COLL 5.2.26 R (1) (Investment in deposits).

5.4.9

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Where a *scheme* generates leverage through the reinvestment of collateral, this should be taken into account in the calculation of the *scheme's* global exposure.

[Note: CESR's *UCITS eligible assets guidelines* with respect to article 11 of the *UCITS eligible assets Directive* (part)]

5.4.10

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