

## Chapter 8

# Qualified investor schemes



8.4 Investment and borrowing powers

Application

- 8.4.1
- R
- (1) Subject to (1A), this section applies to an *ICVC* which is a *qualified investor scheme* and an *authorised fund manager* and a *depository* of a *qualified investor scheme*.

(1A) Other than ■ COLL 8.4.2R, ■ COLL 8.4.4CG, ■ COLL 8.4.7R, ■ COLL 8.4.8R and ■ COLL 8.4.9AG this section does not apply where the *qualified investor scheme* in question is a *regulated money market fund*.

- 8.4.1A
- R
- (1) Where this section refers to a second *scheme*, and the second *scheme* is a *feeder scheme*, which (in respect of investment in *units* in *collective investment schemes*) is *dedicated* to *units* in a single *collective investment scheme*, the reference in this section to the second *scheme* must be read as if it were a reference to any *scheme* into which the *feeder scheme's* master *scheme* invests.

(2) Where this section refers to a second *scheme*, and the second *scheme* is a master *scheme* to which (in respect of investment in *units* in *collective investment schemes*) the relevant *qualified investor scheme* is *dedicated*, the reference in this section to the second *scheme* must be read as if it were a reference to any *scheme* into which that master *scheme* invests.

Spread of risk

- 8.4.2
- R
- An *authorised fund manager* must take reasonable steps to ensure that the *scheme property* of a *qualified investor scheme* provides a spread of risk, taking into account the investment objectives and policy of the *scheme* as stated in the most recently published *prospectus*, and in particular, any investment objective as regards return to the *unitholders* (whether through capital appreciation or income or both).

Investment powers: general

- 8.4.3
- R
- (1) The *scheme property* of a *qualified investor scheme* may, subject to the *rules* in this chapter, comprise any assets or *investments* to which it is *dedicated*.

(2) The *instrument constituting the fund* and the *prospectus* may further restrict:

(a) the kinds of assets in which the *scheme property* may be invested;

- (b) the types of transactions permitted and any relevant limits; and
- (c) the borrowing powers of the *scheme*.

#### Qualified investor schemes: general

8.4.4

**R**

The *scheme property* of a *qualified investor scheme* must, except where otherwise provided by the *rules* in this chapter, consist only of one or more of the following to which it is *dedicated*:

- (1) any *specified investment*:
  - (a) within articles 74 to 86 of the *Regulated Activities Order*; and
  - (b) within article 89 (Rights to or interests in investments) of the *Regulated Activities Order* where the right or interest relates to a *specified investment* within (a);
- (2) an interest in an immovable under ■ COLL 8.4.11 R (Investment in property);
- (3) *precious metals*; or
- (4) a *commodity* contract traded on an *RIE* or a *recognised overseas investment exchange*.

#### Money market funds

8.4.4A

**R**

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8.4.4B

**R**

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8.4.4C

**G**

Investment powers and limits for *qualified investor schemes* that are *regulated money market funds* are set out in the *Money Market Funds Regulation*. Subject to complying with that Regulation, the *instrument constituting the fund* may further restrict:

- (1) the kinds of assets in which the *scheme property* may be invested;
- (2) the types of transactions permitted and any relevant limits; and
- (3) the borrowing powers of the *scheme*.

#### Investment in collective investment schemes

8.4.5

**R**

- (1) A *qualified investor scheme* may invest in *units* in a *scheme* (a '*second scheme*') only if the *second scheme* is:
  - (a) a *regulated collective investment scheme*; or
  - (b) a *scheme* not within (a) where the *authorised fund manager* has taken reasonable care to determine that:
    - (i) it is the subject of an independent annual audit conducted in accordance with international standards on auditing;

- (ii) the calculation of the net asset value of each of the second schemes and the maintenance of their accounting records is segregated from the investment management function;
- (iii) (unless it is a master scheme to whose units the relevant qualified investor scheme is dedicated) it is prohibited from investing more than 15% of its value in units of schemes or, if there is no such prohibition, the qualified investor scheme's authorised fund manager is satisfied, on reasonable grounds and after making all reasonable enquiries, that no such investment will be made; and
- (iv) it operates in accordance with the principle of risk spreading as described in ■ COLL 8.4.2 R.

- (2) A qualified investor scheme must not invest more than 20% in value of the scheme property in units in second schemes which are unregulated schemes or qualified investor schemes unless the authorised fund manager has carried out appropriate due diligence on each of the second schemes and has taken reasonable care to determine that, after making all reasonable enquiries and on reasonable grounds, the second scheme complies with relevant legal and regulatory requirements.
- (3) The authorised fund manager of a qualified investor scheme with more than 20% in value of the scheme property invested in one or more second schemes which are unregulated schemes or qualified investor schemes must carry out appropriate due diligence on those schemes on an ongoing basis.

Investment in a collective investment scheme that is an umbrella

- 8.4.5A

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Where the second scheme in ■ COLL 8.4.5 R is an umbrella, the provisions apply to each sub-fund as if it were a separate scheme.
- 8.4.5B

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  - (1) The guidance at ■ COLL 5.7.11 G applies to an authorised fund manager of a qualified investor scheme carrying out due diligence for the purpose of ■ COLL 8.4.5 R, as if that guidance related to ■ COLL 8.4.5 R.
  - (2) Where ■ COLL 5.7.11G (10) refers to ■ COLL 6.3 (Valuation and pricing), that reference should be read as if it were a reference to ■ COLL 8.5.9 R (Valuation, pricing and dealing).
  - (3) In addition to the guidance at ■ COLL 5.7.11 G the authorised fund manager should, as part of its due diligence process, consider whether the property of each of the second schemes is held in safekeeping by a third party, which is subject to prudential regulation and independent of the investment manager of the second scheme and, if not, what controls over the property of the second scheme are in place to protect investors.

### Delivery of property under a transaction in derivatives or a commodities contract

8.4.6

**R**

- (1) An *authorised fund manager* must take reasonable care to determine the following when entering into any transaction in *derivatives* or any *commodity* contract which may result in any asset becoming part of the *scheme property*:
  - (a) if it is an asset in which the *scheme property* could be invested, that the transaction:
    - (i) can be readily closed out; or
    - (ii) would at the expected time of delivery relate to an asset which could be included in the *scheme property* under the *rules* in this chapter; or
  - (b) in any other case that the transaction can be readily closed out.
- (2) An *authorised fund manager* may acquire an asset within (1) if its determination has proved incorrect and if it determines that acquisition is in the interests of the *unitholders*, provided it has the consent of the *depository*.
- (3) Any asset within (1) acquired in accordance with (2) may form part of the *scheme property* despite any other *rule* in this chapter until the position can be rectified.

### Cover for transactions in derivatives and forward transactions

8.4.7

**R**

- (1) A transaction in *derivatives* or a forward transaction may be entered into only if the maximum exposure, in terms of the *principal* or *notional principal* created by the transaction to which the *scheme* is or may be committed by another *person*, is covered globally under (2).
- (2) Exposure is globally covered if adequate cover from within the *scheme property* is available to meet the *scheme's* total exposure taking into account any reasonably foreseeable market movement.
- (3) The total exposure relating to *derivatives* held in a *qualified investor scheme* may not exceed the net value of the *scheme property*.
- (4) No element of cover may be used more than once.

### Valuation of an OTC derivative

8.4.7A

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A transaction in an *OTC derivative* must be capable of valuation which it will only be 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:

- (1) on the basis of the pricing model; or
- (2) on some other reliable basis reflecting an up-to-date market value;

which has been agreed between the *authorised fund manager* and the *depository*.

### Continuing nature of limits and requirements

8.4.8

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- (1) An *authorised fund manager* must, as frequently as necessary to ensure compliance with ■ COLL 8.4.7 R (2) and ■ COLL 8.4.7 R (4), re-calculate the amount of cover required in respect of *derivatives* and forwards positions in existence under this chapter.
- (2) *Derivatives* and forwards positions may be retained in the *scheme property* only so long as they remain covered globally under ■ COLL 8.4.7 R.
- (3) An *authorised fund manager* must use a risk management process enabling it to monitor and measure as frequently as appropriate the risk of a *scheme's derivatives* positions and their contribution to the overall risk profile of the *scheme*.

### Permitted stock lending

8.4.9

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- (1) The *ICVC*, or the *depository* at the request of the *ICVC*, or the *depository* of an *AUT* or *ACS* at the request of the *authorised fund manager*, may enter into a *repo* contract or a *stock lending* arrangement within section 263B of the Taxation of Chargeable Gains Act 1992 (without extension by section 263C).
- (2) The *depository* must ensure that the value of any *collateral*, for the *stock lending* arrangement is at all times at least equal to the value of the securities transferred by the *depository*.
- (3) In the case of the expiry of validity of any *collateral*, the duty in (2) is satisfied if the *depository* or the *authorised fund manager*, as appropriate, takes reasonable care to determine that sufficient *collateral* will be transferred by close of business on the *day* of expiry.

8.4.9A

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The *Money Market Funds Regulation* sets out restrictions in relation to *stock lending* and *repo* contracts that apply in respect of *regulated money market funds*.

### General power to borrow

8.4.10

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- (1) The *ICVC* or *depository* of an *AUT* or *ACS* (on the instructions of the *authorised fund manager*) may borrow money for the use of the *authorised fund* on terms that the borrowing is to be repayable out of the *scheme property*.
- (2) The *authorised fund manager* must ensure that the *authorised fund's* borrowing does not, on any *day*, exceed 100 % of the net value of the *scheme property* and must take reasonable care to ensure that arrangements are in place that will enable borrowings to be closed out to ensure such compliance.
- (3) In this rule "borrowing" also includes any arrangement (including a combination of *derivatives*) designed to achieve a temporary injection of money into the *scheme property* in the expectation that the sum will be repaid.

**8.4.11**

**R**

- (4) Where the limit in (2) is breached, the *authorised fund manager* must take action in accordance with the principles set out in ■ COLL 8.5.3 R (3) to ■ COLL 8.5.3 R (5) (Duties of the authorised fund manager: investment and borrowing powers) to deal with that breach.

**Investment in property**

- (1) Any investment in land or a building held within the *scheme property* of a *qualified investor scheme* must be in an immovable within (2).
- (2) For an immovable :
- (a) it must be situated in a country or territory identified in the *prospectus*;
  - (b) the *authorised fund manager* must have taken reasonable care to determine that the title to the interest in the immovable is a good marketable title; and
  - (c) the *authorised fund manager* of an *AUT* or *ACS* or the *ICVC* must have received a report from the *appropriate valuer* that:
    - (i) contains a valuation of the interest in the immovable (with and without any relevant existing mortgage); and
    - (ii) states that in the *appropriate valuer's* opinion the interest in the immovable would if acquired by the *scheme*, be capable of being disposed of reasonably expeditiously at that valuation;
  - (d) unless (c) is satisfied, the *authorised fund manager* of an *AUT* or *ACS* or the *ICVC* must have received a report from an *appropriate valuer* valuing the interest in the immovable and stating that:
    - (i) the immovable is adjacent to or in the vicinity of another immovable included in the *scheme property*; and
    - (ii) in the opinion of the *appropriate valuer*, the total value of the interests in both immovables would at least equal the sum of the price payable for the interest in the immovable and the existing value of the interest in the other immovable; and
  - (e) it must not be bought:
    - (i) if it becomes apparent to the *authorised fund manager* that the report in either (c) or (d) could no longer reasonably be relied upon; or
    - (ii) at a price more than 105% of the valuation relevant to the interest for that immovable in the report in either (c) or (d).
- (3) Any contents of any building may be regarded as part of the relevant immovable.
- (4) An *appropriate valuer* must be a *person* who:
- (a) has knowledge of and experience in the valuation of immovables of the relevant kind in the relevant area;
  - (b) is qualified to be a *standing independent valuer* of an *authorised fund* or is considered by the *scheme's standing independent valuer* to hold an equivalent qualification;

- (c) is independent of the *ICVC*, the *depository* and each of the *directors* of the *ICVC* or of the *authorised fund manager* and *depository* of the *AUT* or *ACS*; and
- (d) has not engaged himself or any of his *associates* in relation to the finding of the immovable for the *scheme* or the finding of the *scheme* for the immovable.

### Investment in overseas property through an intermediate holding vehicle

8.4.11A

**R**

- (1) An overseas immovable may be held by a *scheme* through an *intermediate holding vehicle* whose purpose is to enable the holding of immovables by the *scheme* or a series of such *intermediate holding vehicles*, provided that the interests of *unitholders* are adequately protected. Any investment in an *intermediate holding vehicle* for the purpose of holding an overseas immovable shall be treated for the purposes of this section as if it were a direct investment in that immovable.
- (2) An *intermediate holding vehicle* must be wholly owned by the *scheme* or another *intermediate holding vehicle* or series of *intermediate holding vehicles* wholly owned by the *scheme*, unless and to the extent that local legislation or regulation relating to the *intermediate holding vehicle* holding the immovable requires a proportion of local ownership.

8.4.11B

**G**

- (1) The *authorised fund manager* may transfer capital and income between an *intermediate holding vehicle* and the *scheme* by the use of inter-company debt if the purpose of this is for investment in immovables and repatriation of income generated by such investment. In using inter-company debt, the *authorised fund manager* should ensure the following:
  - (a) a record of inter-company debt is kept in order to provide an accurate audit trail; and
  - (b) interest paid out on the debt instruments is equivalent to the net rental income earned from the immovables after deduction of the *intermediate holding vehicle's* reasonable running costs (including tax).
- (2) An *intermediate holding vehicle* should undertake the purchase, sale and management of immovables on behalf the *scheme* in accordance with the *scheme's* investment objectives and policy.
- (3) Wherever reasonably practicable, an *intermediate holding vehicle* should have the same auditor and accounting reference date as the *scheme*.
- (4) The accounts of any *intermediate holding vehicle* should be consolidated into the annual and interim reports of the *scheme*.
- (5) The *authorised fund manager* should provide sufficient information to enable the *depository* to fulfil its duties under *COLL* in relation to the immovables held through an *intermediate holding vehicle*.

### Investment limits for immovables

8.4.12

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The following limits apply in respect of immovables held as part of the *scheme property*:

- (1) the amount secured by mortgages over any immovable must not exceed 100% of the latest valuation by an *appropriate valuer* under ■ COLL 8.4.11 R (2)(c) or ■ COLL 8.4.11 R (2)(d) or ■ COLL 8.4.13 R, as appropriate;
- (2) no option may be granted to a *person* to buy or obtain an interest in any immovable comprised in the *scheme property* if this might unduly prejudice the ability to provide *redemption*; and
- (3) the total of all premiums paid for options to purchase immovables must not exceed 10% of the *scheme value* in any 12 *month* period, calculated at the date of the granting of the option.

### Standing independent valuer and valuation

8.4.13

**R**

(1) In relation to the appointment of a valuer the *authorised fund manager* must:

- (a) at the outset appoint the *standing independent valuer* with the approval of the *depository* and likewise upon any vacancy; and
- (b) ensure that any immovables in the *scheme property* are valued by an *appropriate valuer* (*standing independent valuer*) appointed by the *authorised fund manager*.

(2) The following apply in relation to the functions of the *standing independent valuer*:

- (a) the *authorised fund manager* must ensure that the *standing independent valuer* appointed under (1), procures the valuation of all the immovables held within the *scheme property*, on the basis of a full valuation with physical inspection (including, where the immovable is or includes a building, internal inspection) at least once a year;
- (b) for the purposes of (a), any inspection in relation to adjacent properties of a similar nature and value may be limited to that of only one such representative property;
- (c) the *authorised fund manager* must ensure that the *standing independent valuer* values the immovables, on the basis of a review of the last full valuation, at least once a *month*;
- (d) if either the *authorised fund manager* or the *depository* becomes aware of any matter which appears likely to:
  - (i) affect the outcome of a valuation of an immovable; or
  - (ii) cause the valuer to decide to value under (a), instead of under (c),
it must immediately inform the *standing independent valuer* of that matter;
- (e) the *authorised fund manager* must use its best endeavours to ensure that any other *affected person* reports to the *standing independent valuer* immediately upon that *person* becoming aware of any matter within (d); and

- (f) any valuation by the *standing independent valuer* must be undertaken in accordance with UKVPS 3 and 2.3 of UKVPGA 2 of the RICS Valuation – Global Standards 2017 UK national supplement 2018 (the RICS Red Book) or, in the case of overseas immovables, on an appropriate basis but subject to any provisions of the *instrument constituting the fund*.
- (3) In relation to immovables:
  - (a) any valuation under this *rule* has effect, until the next valuation under this *rule*, for the purposes of the value of immovables; and
  - (b) an agreement to transfer an immovable or an interest in an immovable is to be disregarded for the purpose of the valuation of the *scheme property* unless it reasonably appears to the *authorised fund manager* to be legally enforceable.

8.4.14

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In considering whether a valuation of overseas immovables by the *standing independent valuer* is made on an appropriate basis for the purpose of ■ COLL 8.4.13R (2)(f), the *authorised fund manager* should consider whether that valuation was made in accordance with internationally accepted valuation principles, procedures and definitions as set out in the International Valuation Standards published by the International Valuation Standards Committee.