Powers exercised

A. The Financial Services Authority makes this instrument in the exercise of the following powers and related provisions:

(1) the following sections of the Financial Services and Markets Act 2000 (“the Act”):
   (a) section 138 (General rule-making power);
   (b) section 140 (Restriction on managers of authorised unit trust schemes);
   (c) section 156 (General supplementary powers);
   (d) section 157 (Guidance);
   (e) section 238(5) (Restrictions on promotion);
   (f) section 242 (Applications for authorisation of unit trust schemes);
   (g) section 247 (Trust scheme rules); and
   (h) section 248 (Scheme particulars rules); and

(2) Regulation 6 (FSA rules) of the Open-Ended Investment Companies Regulations 2001 (SI 2001/1228).

B. The rule-making powers and related provisions listed above are specified for the purpose of section 153(2) of the Act (Rule-making instruments).

Commencement

C. This instrument comes into force on 6 November 2006, except that text in Annex A which is placed in bold square brackets is deleted with effect from 12 February 2007.

Amendments to the Handbook

D. The modules of the FSA's Handbook of rules and guidance listed in column (1) below are amended in accordance with the Annexes to this instrument listed in column (2).

<table>
<thead>
<tr>
<th>(1)</th>
<th>(2)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Glossary of definitions</td>
<td>Annex A</td>
</tr>
<tr>
<td>New Collective Investment Schemes sourcebook (COLL)</td>
<td>Annex B</td>
</tr>
</tbody>
</table>

Citation

E. This instrument may be cited as the New Collective Investment Schemes Sourcebook (OTC Derivative Requirements and other Miscellaneous Amendments) Instrument 2006.

By order of the Board
25 October 2006
Annex A

Amendments to the Glossary of definitions

In this Annex, underlining indicates new text and striking through indicates deleted text. Handbook text in this Annex placed in bold square brackets is deleted with effect from 12 February 2007 but is not shown struck through.

Amend the following definition as shown:

... marketing (in COLL [and CIS]) (in relation to marketing units in a regulated collective investment scheme in a particular country or territory):

(a) communicating to a person in that country or territory an invitation or inducement to become, or offer to become, a holder in that authorised fund regulated collective investment scheme;

(b) giving advice on investments to, or arranging (bringing about) a deal in an investment for a person in that country or territory to become a holder in that authorised fund regulated collective investment scheme.

...
Annex B

Amendments to the New Collective Investment Schemes sourcebook (COLL)

In this Annex, underlining indicates new text and striking through indicates deleted text.

Table: contents of the prospectus

4.2.5 R This table belongs to COLL 4.2.2R (Publishing the prospectus).

Contracts and other relationships with parties

11 The following relevant details:

(h) in what capacity (if any), the authorised fund manager acts in relation to any other regulated collective investment schemes and …

Investment in collective investment schemes

5.2.13 R …

(4) where the second scheme is an umbrella, the provisions in (2) and (3) and COLL 5.2.11R (Spread: general) apply to each sub-fund as if it were a separate scheme.

OTC transactions in derivatives

5.2.23 R A transaction in an OTC derivative under COLL 5.2.20R (1)(b) must be:

(2) on approved terms: the terms of the transaction in derivatives are approved only if, before the transaction is entered into, the depositary is satisfied that the counterparty has agreed with the ICVC or the authorised fund manager:

(b) that it or an alternative counterparty will, at the request of the ICVC or authorised fund manager, enter into a further transaction to sell, liquidate or close out that transaction at
Risk management process

5.2.25 G …

(2) The depositary should take reasonable care to review the appropriateness of the risk management process in line with its duties under COLL 6.6.4R (General duties of the depositary) and COLL 6.6.14R (Duties of the depositary and authorised fund manager: investment and borrowing powers), as appropriate.

Transferable securities and money-market instruments

5.6.5 R …

(1) be admitted to or dealt in on an eligible market within COLL 5.2.10R (Eligible markets: requirements); and or

Spread: general

5.6.7 R …

(7) For the purpose of calculating the limit in (5), the exposure in respect of an OTC derivative may be reduced to the extent that collateral is held in respect of it if the collateral meets each of the conditions specified in (8).

(8) The conditions referred to in (7) are that the collateral:

(a) is marked-to-market on a daily basis and exceeds the value of the amount at risk;

(b) is exposed only to negligible risks (e.g. government bonds of first credit rating or cash) and is liquid;

(c) is held by a third party custodian not related to the provider or is legally secured from the consequences of a failure of a related party; and

(d) can be fully enforced by the non-UCITS retail scheme at any time.

(9) For the purpose of calculating the limit in (5), OTC derivative positions with the same counterparty may be netted provided that the netting procedures:

(a) comply with the conditions set out in Section 3 (Contractual netting (Contracts for novation and other netting agreements))
of Annex III to the Banking Consolidation Directive; and

(b) are based on legally binding agreements.

(10) In applying this rule, all derivatives transactions are deemed to be free of counterparty risk if they are performed on an exchange where the clearing house meets each of the following conditions:

(a) it is backed by an appropriate performance guarantee; and

(b) it is characterised by a daily mark-to-market valuation of the derivative positions and an at least daily margining.

5.6.7A G Guidance on spread: general

(1) COLL 5.6.7R (7) to (10) replicate the provisions of Article 5 of the Commission Recommendation 2004/383/EC of 27 April 2004 on the use of financial derivative instruments for undertakings for collective investment in transferable securities, so as to enable non-UCITS retail schemes to benefit from the same flexibility. This Recommendation may be accessed via http://europa.eu.int/eur-lex/pri/en/oj/dat/2004/l_199/l_19920040607en00240029.pdf

(2) The attention of authorised fund managers is specifically drawn to condition (d) in COLL 5.6.7R (8) under which the collateral has to be legally enforceable at any time. It is the FSA’s view that it is advisable for an authorised fund manager to undertake a legal due diligence exercise before entering into any financial collateral arrangement. This is particularly important where the collateral arrangements in question have a cross-border dimension. The depositary will also need to exercise reasonable care to review the collateral arrangements in accordance with its duties under COLL 6.6.4 (General duties of the depositary).

Investment in collective investment schemes

5.6.10 R ...

(5) where the second scheme is an umbrella, the provisions in (2) to (4) and COLL 5.6.7R (Spread: general) apply to each sub-fund as if it were a separate scheme.

Derivatives: general

5.6.12 R (1) ...

(a) of a kind specified in COLL 5.2.20R COLL 5.6.13R (Permitted transactions (derivatives and forwards)); and
Permitted transactions (derivatives and forwards)

5.6.13  R  (1)  …

(a) the underlying must be within COLL 5.2.20R (2) or COLL 5.6.4R (5) (Investment powers: general) or COLL 5.2.20R (2)(f) to (i) ; and

Risk management process

5.6.17  G  …

(2) The depositary should take reasonable care to review the appropriateness of the risk management process in line with its duties under COLL 6.6 (Powers and duties of the scheme, the authorised fund manager and the depositary) COLL 6.6.4R (General duties of the depositary) and COLL 6.6.14R (Duties of the depositary and authorised fund manager: investment and borrowing powers), as appropriate.

Cash, borrowing, lending and other provisions

5.6.22  R  …

(2) COLL 5.5.1R (Application) and COLL 5.5.2R (Table of application);

Duties of the depositary and the authorised fund manager: investment and borrowing powers

6.6.14  R  (1) The authorised fund manager must avoid the scheme property being used or invested contrary to COLL 5, or any provision in the instrument constituting the scheme or the prospectus as referred to in COLL 5.2.4R (Investment powers: general) and COLL 5.6.4R (Investment powers: general), except to the extent permitted by (3)(b).