

**COLLECTIVE INVESTMENT SCHEMES SOURCEBOOK
(UCITS ELIGIBLE ASSETS DIRECTIVE AND OTHER AMENDMENTS)
INSTRUMENT 2008**

Powers exercised

- A. The Financial Services Authority makes this instrument in the exercise of the powers and related provisions in or under:
- (1) the following sections of the Financial Services and Markets Act 2000 (“the Act”):
 - (a) section 138 (General rule-making power);
 - (b) section 156 (General supplementary powers);
 - (c) section 157(1) (Guidance);
 - (d) section 247 (Trust scheme rules); and
 - (e) section 248 (Scheme particulars rules); and
 - (2) regulation 6 (FSA rules) of the Open-Ended Investment Companies Regulations 2001 (SI 2001/1228); and
 - (3) the other powers and related provisions listed in Schedule 4 (Powers exercised) to the General Provisions of the Handbook.
- B. The rule-making powers listed above are specified for the purpose of section 153(2) (Rule-making instruments) of the Act.

Commencement

- C. This instrument comes into force as follows:
- (1) Part 1 of Annex B comes into force on 6 March 2008;
 - (2) the remainder of this instrument comes into force on 23 July 2008.

Amendments to the Handbook

- D. The Glossary of definitions is amended in accordance with Annex A to this instrument.
- E. The Collective Investment Schemes sourcebook (COLL) is amended in accordance with Annex B to this instrument.

Citation

- F. This instrument may be cited as the Collective Investment Schemes Sourcebook (UCITS Eligible Assets Directive and Other Amendments) Instrument 2008.

By order of the Board
28 February 2008

Annex A

Amendments to the Glossary of definitions

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

Insert the following new definitions in the appropriate alphabetical position. The text is not underlined.

<i>approved money-market instrument</i>	(in accordance with <i>COLL</i> 5.2.7FR) 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.
<i>CESR's UCITS eligible assets guidelines</i>	The Committee of European Securities Regulators' guidelines concerning eligible assets for investment by undertakings for collective investment in transferable securities (CESR/07-044). These are available at http://www.fsa.gov.uk/pages/Library/Other_publications/EU/eu_docs/index.shtml
<i>efficient portfolio management</i>	(in <i>COLL</i> and in accordance with article 11 of the <i>UCITS eligible assets Directive</i>) techniques and instruments which relate to <i>transferable securities</i> and <i>approved money-market instruments</i> and which fulfil the following criteria: (a) they are economically appropriate in that they are realised in a cost effective way; (b) they are entered into for one or more of the following specific aims: (i) reduction of risk; (ii) reduction of cost; (iii) generation of additional capital or income for the <i>scheme</i> with a risk level which is consistent with the risk profile of the <i>scheme</i> and the risk diversification rules laid down in <i>COLL</i> .
<i>UCITS eligible assets Directive</i>	Commission Directive 2007/16/EC implementing Council Directive 85/611/EEC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) as regards the clarification of certain definitions.

Amend the following definition as shown.

- qualifying money market fund*
- (1) (in *COLL* and *CASS 7*) a *collective investment scheme* authorised under the *UCITS Directive* or which is subject to supervision and, if applicable, authorised by an authority under the national law of an *EEA State*, and which satisfies the following conditions:
- (a) ...
- (b) it must, with a view to achieving that primary investment objective, invest exclusively in high quality money market instruments with a maturity or residual maturity of no 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. It may also achieve this objective by investing on an ancillary basis in deposits with credit institutions;
- (c) ...
- ...

Annex B

Amendments to the Collective Investment Schemes sourcebook (COLL)

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

Part 1: Changes which come into force on 6 March 2008

COLL TP 1

Transitional Provisions

(1)	(2)	(3)	(4)	(5)	(6)
	Material to which the transitional provision applies		Transitional provision	Transitional provision: dates in force	Hand-book provision: coming into force
...					
14	<u>Amendments to <i>COLL</i> made by the Collective Investment Schemes Sourcebook (UCITS Eligible Assets Directive and Other Amendments) Instrument 2008</u>	R	<p>(1) <u>The <i>authorised fund manager</i> of an <i>authorised fund</i> may elect for early compliance with the instrument, in which case <i>COLL</i> applies as if it had been amended by the instrument.</u></p> <p>(2) <u>An election is irrevocable and does not take effect until the <i>authorised fund manager</i> notifies the <i>depository</i> and the <i>FSA</i> in writing of the date it takes effect.</u></p> <p>(3) <u>The <i>authorised fund manager</i> must make a</u></p>	<p><u>From 6 March 2008 until 23 July 2008</u></p> <p><u>From 6 March 2008 until 23 July 2008</u></p> <p><u>From 6 March 2008</u></p>	<p><u>23 July 2008 except for this part of the instrument which comes into force on 6 March 2008</u></p>

record of the election and retain it for a period of six years from the date it takes effect. until 6 years from the date the relevant election took effect

...

Schedule 1

Record keeping requirements

Handbook reference	Subject of record	Contents of record	When record must be made	Retention period
<i>COLL</i> Transitional Provision 3	Election or revocation to comply with <i>CIS</i>	Details	At election or revocation	6 years
<u><i>COLL</i> Transitional Provision 14</u>	<u>Election for early compliance with the instrument</u>	<u>Details</u>	<u>At election</u>	<u>6 years</u>

...

Schedule 2

Notification requirements

...

Handbook reference	Matter to be notified	Contents of notification	Trigger event	Time allowed
<i>COLL</i> Transitional Provision 3	Election or revocation to comply with <i>CIS</i>	Details and the date from which it is to take effect	At election or revocation	Immediate
<u><i>COLL</i> Transitional Provision 14</u>	<u>Election for early compliance with the instrument</u>	<u>Details and the date from which it is to take effect</u>	<u>At election</u>	<u>Immediate</u>

Part 2: Changes which come into force on 23 July 2008

4.2.5 R Table: contents of the prospectus

...

...	
Investment objectives and policy	
3	The following particulars of the investment objectives and policy of the <i>authorised fund</i> :
	...
	(m) where <i>derivatives</i> transactions may be used in a <i>scheme</i> , a prominent statement as to whether these transactions are for the purposes of <i>efficient portfolio management (including hedging)</i> or meeting the investment objectives or both and...
	...
...	

5.2.2 R Table of application

This table belongs to *COLL 5.2.1R*.

Rule	<i>ICVC</i>	<i>ACD</i>	<i>Manager of an AUT</i>	<i>Depository of an ICVC</i>	<i>Trustee of an AUT</i>
...					
5.2.10R(3)
<u>5.2.10AR to 5.2.10EG</u>		<u>x</u>	<u>x</u>		
...					
5.2.23R(2) to (4)	x	x	x	x	x
5.2.23R(3)	x	x	x	x	x
...					

5.2.2A G 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 http://www.fsa.gov.uk/pages/Library/Other_publications/EU/eu_docs/index.shtml.

UCITS schemes: permitted types of scheme property

5.2.6A R 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 necessary for the direct pursuit of the *ICVC's* business;

in accordance with the *rules* in this section.

[Note: articles 19(1) (in conjunction with other *rules* in this section) and (2)(c) of the *UCITS Directive*]

...

Investment in transferable securities

5.2.7A R (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 6.2.16R(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 G Where the authorised fund manager considers that the liquidity or negotiability of a transferable security might compromise the ability of the authorised fund manager to comply with its obligation to redeem units at the request of any qualifying unitholder, it should assess the liquidity risk in accordance with CESR's UCITS eligible assets guidelines with respect to article 2(1) of the UCITS eligible assets Directive.

Closed end funds constituting transferable securities

5.2.7C R 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 5.2.7AR, and either:

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

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

- 5.2.7D G (1) An authorised fund manager should not invest the scheme property of a UCITS scheme in units of a closed end fund for the purpose of circumventing the investment limits set down in this section.
- (2) When required to assess whether the corporate governance mechanisms of a closed end fund in contractual form are equivalent to those applied to companies, the authorised fund manager should consider whether the contract on which the closed end fund is based provides its investors with rights to:
- (a) vote on the essential decisions of the closed end fund (including appointment and removal of asset management company, amendment to the contract which set up the closed end fund, modification of investment policy, merger, liquidation); and
 - (b) control the investment policy of the closed end fund through appropriate mechanisms.
- (3) The assets of the closed end fund in contractual form should be separate and distinct from those of the asset manager and the closed end fund should be subject to liquidation rules that adequately protect its investors.

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

Transferable securities linked to other assets

- 5.2.7E R (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 5.2.7AR; 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 R 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 1(9) of the UCITS Directive]

5.2.7G R 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 R (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 6.2.16R(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 G (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*]

UCITS schemes: ~~general~~ Transferable securities and money-market instruments generally to be admitted to or dealt in on an eligible market

- 5.2.8 R (1) ~~The scheme property of a UCITS scheme must, except where otherwise provided in the rules in this chapter, consist only of any or all of:~~
- (a) ~~transferable securities;~~
 - (b) ~~units in collective investment schemes permitted under COLL 5.2.13 R (Investment in collective investment schemes);~~
 - (c) ~~approved money-market instruments permitted under COLL 5.2.18R (Investment in money market instruments);~~
 - (d) ~~derivatives and forward transactions permitted under COLL 5.2.20R (Permitted transactions (derivatives and forwards));~~
and
 - (e) ~~deposits permitted under COLL 5.2.26R (Investment in~~

deposits). [deleted]

- (2) For an *ICVC* the *scheme property* may also include movable and immovable property that is necessary for the direct pursuit of the *ICVC's* business. [deleted]
- (3) *Transferable securities* and ~~money-market instruments~~ approved money-market instruments held within a *UCITS* scheme must be:
 - ..
 - (d) for a ~~money-market instrument~~ an approved money-market instrument not admitted to or *dealt in* on an *eligible* market, within ~~*COLL 5.2.18R(2)*~~ *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) ~~Not more than 10% in value of the *scheme property* of a *UCITS* scheme is to consist of *transferable securities* which do not fall within (3) or of money-market instruments, which do not fall within *COLL 5.2.18R(2)*. 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 19(1)(a)-(d) and (h) and 2(a) of the *UCITS Directive* and article 3(1) of the *UCITS eligible assets Directive*]

...

Money-market instruments with a regulated issuer

- 5.2.10A R (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 5.2.10BR*.

[Note: article 19(1)(h), first to third indents 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 5.2.10CR*; and
- (c) the instrument is freely transferable.

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

Issuers and guarantors of money-market instruments

- 5.2.10B R (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 Community law; or
 - (ii) subject to and complies with prudential rules considered by the *FSA* to be at least as stringent as those laid down by Community 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 Community law.

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

Appropriate information for money-market instruments

5.2.10C R (1) In the case of an *approved money-market instrument* within *COLL 5.2.10BR(1)(b)* or issued by a body of the type referred to in *COLL 5.2.10EG*; or which is issued by an authority within *COLL 5.2.10BR(1)(a)(ii)* or a public international body within *COLL 5.2.10BR(1)(a)(vi)* but is not guaranteed by a central authority within *COLL 5.2.10BR (1)(a)(i)*, the following information must be available:

- (a) information on both the issue or the issuance programme, and the legal and financial situation of the issuer prior to the issue of the instrument, verified by appropriately qualified third parties not subject to instructions from the issuer;
- (b) updates of that information on a regular basis and whenever a significant event occurs; and
- (c) available and reliable statistics on the issue or the issuance programme.

(2) In the case of an *approved money-market instrument* issued or guaranteed by an establishment within *COLL 5.2.10BR(1)(c)*, the following information must be available:

- (a) information on the issue or the issuance programme or on the legal and financial situation of the issuer prior to the issue of the instrument;
- (b) updates of that information on a regular basis and whenever a significant event occurs; and
- (c) available and reliable statistics on the issue or the issuance programme, or other data enabling an appropriate assessment of the credit risks related to investment in those instruments.

- (3) In the case of an *approved money-market instrument*:
- (a) within *COLL 5.2.10BR(1)(a)(i), (iv) or (v)*; or
 - (b) which is issued by an authority within *COLL 5.2.10BR(1)(a)(ii)* or a public international body within *COLL 5.2.10BR(1)(a)(vi)* and is guaranteed by a central authority within *COLL 5.2.10BR(1)(a)(i)*;

information must be available on the issue or the issuance programme, or on the legal and financial situation of the issuer prior to the issue of the instrument.

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

- 5.2.10D G (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 G (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 *FSA* (which takes the form of a *waiver* under section 148 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 (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 Community law or an establishment which is subject to and complies with prudential rules considered by the FSA (in accordance with COLL 5.2.10BR(2)) to be at least as stringent as those laid down by Community law.

[Note: article 19(1)(h), fourth indent of the UCITS Directive and article 7 of the UCITS eligible assets Directive]

5.2.11 R ...

- (4) Not more than 5% in value of the *scheme property* is to consist of *transferable securities* or ~~money-market instruments~~ 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*.

...

- (8) Not more than 20% in value of the *scheme property* is to consist of *transferable securities* and ~~money-market instruments~~ approved money-market instruments issued by the same group (as referred to in (2)).

...

- (10) In applying the limits in (3),(4),(5), (6) and (7), 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 ~~money-market instruments~~ approved money-market instruments issued by; or
- (b) ...

...

[**Note:** article 22 of the *UCITS Directive*]

...

5.2.12 R ...

- (6) Notwithstanding COLL 5.2.11R(1) and subject to (2) and (3), in applying the 20% limit in COLL 5.2.11R(10) with respect to a single body, government and public securities issued by that body shall be taken into account.

...

Investment in ~~warrants and~~ nil and partly paid securities

5.2.17 R (1) ~~Where a UCITS scheme invests in a warrant, the exposure created by the exercise of the right conferred by that warrant must not exceed the limits in COLL 5.2.11R (Spread: general) and COLL 5.2.12R (Spread: government and public securities). [deleted]~~

- (2) ~~A transferable security or a money market instrument~~ an approved money-market instrument on which any sum is unpaid...

...

Investment in money market instruments

5.2.18 R ~~A UCITS scheme may invest in money market instruments which are normally dealt in on the money market, are liquid and whose value can be accurately determined at any time, provided the money market instrument is:~~

- (1) ~~within COLL 5.2.8R(3) (UCITS schemes: general); or~~
- (2) ~~a money market instrument issued or guaranteed by:~~
- (a) ~~a central, regional or local authority or central bank of an EEA State, the European Central Bank, the European Union or the European Investment Bank, a non EEA State or, in the case of a federal state, by one of the members making up the federation, or by a public international body to which one or more EEA States belong; or~~
- (b) ~~an establishment subject to prudential supervision in accordance with criteria defined by Community law or an establishment which is subject to and complies with prudential rules considered by the FSA to be at least as stringent as those laid down by Community law; or~~
- (3) ~~issued by a body, any securities of which are dealt in on an eligible market. [deleted]~~

Derivatives: general

5.2.19 R ...

(3) Where a *transferable security* or ~~money-market instrument~~ 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*]

...

Guidance on transferable securities and money-market instruments embedding derivatives

5.2.19A G (1) Collateralised debt obligations (CDOs) or asset-backed securities using derivatives, with or without an active management, will generally not be considered as embedding a derivative except if:

(a) they are leveraged, i.e. the CDOs or asset-backed securities are not limited recourse vehicles and the investors' loss can be higher than their initial investment; or

- (b) they are not sufficiently diversified.
- (2) Where a transferable security or approved money-market instrument embedding a derivative is structured as an alternative to an OTC derivative, the requirements set out in COLL 5.2.23R 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]

5.2.20 R ...

- (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 5.2.8R(3)(a) to (c) and (e);
 - (b) ~~money-market instruments~~ approved money-market instruments permitted under ~~COLL 5.2.18R~~ 8R(3)(a) to (d) (~~Investment in money-market instruments~~);
 - ...
 - (f) financial indices which satisfy the criteria set out in COLL 5.2.20AR;
 - ...
 - (i) ...

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

...

- (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*, ~~money-market instruments~~ 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(3) (Requirement to cover sales) are satisfied.

...

- (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 5.2.6AR (UCITS schemes: permitted types of scheme property) including cash;
 - (c) in the case of an OTC derivative, it complies with the requirements in COLL 5.2.23R (OTC transactions in derivatives);
 - (d) its risks are adequately captured by the risk management process of the authorised fund manager, and by its internal

control mechanisms in the case of risks of asymmetry of information between the *authorised fund manager* and the counterparty to the *derivative*, resulting from potential access of the counterparty to non-public information on *persons* whose assets are used as the underlying by that *derivative*.

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

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

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

Financial indices underlying derivatives

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

replicate it if necessary.

- (4) A financial index is published in an appropriate manner if:
- (a) its publication process relies on sound procedures to collect prices, and calculate and subsequently publish the index value, including pricing procedures for components where a market price is not available; and
 - (b) material information on matters such as index calculation, rebalancing methodologies, index changes or any operational difficulties in providing timely or accurate information is provided on a wide and timely basis.
- (5) Where the composition of underlyings of a transaction in a derivative does not satisfy the requirements for a financial index, the underlyings for that transaction shall where they satisfy the requirements with respect to other underlyings pursuant to COLL 5.2.20R(2), be regarded as a combination of those underlyings.

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

Guidance on financial indices underlying derivatives

- 5.2.20B G (1) An index based on derivatives on commodities or an index on property may be regarded as a financial index of the type referred to in COLL 5.2.20R(2)(f) provided it satisfies the criteria for financial indices set out in COLL 5.2.20AR.
- (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 5.3.3R and spread set out in COLL 5.2.11R.
- (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: *CESR's UCITS eligible assets guidelines* with respect to

article 9 of the UCITS eligible assets Directive]

- (4) When assessing whether a hedge fund index satisfies the requirements for a financial index set out in this section, firms should consider The Committee of European Securities Regulators' guidelines on the classification of hedge fund indices as financial indices (CESR/07-434). Those guidelines are available at http://www.fsa.gov.uk/pages/Library/Other_publications/EU/eu_docs/index.shtml.

...

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 *depository* is satisfied that the counterparty has agreed with the *ICVC* or the *authorised fund manager*:
- (a) to provide, at least daily and at any other time at the request of the *ICVC* or *authorised fund manager*, a reliable and verifiable valuation in respect of that transaction corresponding to its fair value (being the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction) and which does not rely only on market quotations by the counterparty at least daily and at any other time at the request of the *ICVC* or *authorised fund manager*; and
- (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 any time, at a fair value arrived at under the reliable market value basis or pricing model or other reliable basis agreed under (3); ~~and~~
- (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 ~~the pricing model which has been agreed between the *authorised fund manager* and the *depository*; an up-to-date market value which the *authorised fund manager* and the *depository* have agreed is reliable; or~~
- (b) ~~on some other reliable basis reflecting an up-to-date market value which has been so agreed. 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]

Risk management: ~~derivatives~~

5.2.24 R (1) 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 and forwards~~ positions and their contribution to the overall risk profile of the scheme.

...

5.2.25 G ...

(8) An authorised fund manager should undertake the risk assessment with the highest care when the counterparty to the derivative is an associate of the authorised fund manager or the credit issuer.

[Note: CESR's UCITS eligible assets guidelines with respect to article 8(2)(d) of the UCITS eligible assets Directive]

...

5.2.29 R A UCITS scheme:

...

(4) must not acquire more than 10% of the ~~money-market instruments~~ approved money-market instruments issued by any single body; and

...

...

5.2.31 R (1) Notwithstanding COLL 5.2.11R (Spread: general), Aa 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 5.2.33R (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*]

...

...

Index replication

5.2.32 G (1) Where the 20% limit (see COLL 5.2.31R(1)) is raised (subject to the maximum of 35% permitted by COLL 5.2.31R(2)), the *authorised fund manager* should provide appropriate information in the *simplified prospectus*, in order to explain the *authorised fund manager's* assessment of why this increase is justified by exceptional market conditions.

[Note: *CESR's UCITS eligible assets guidelines* with respect to Article 12(2) of the *UCITS eligible assets Directive*]

(2) In the case of a *UCITS scheme* replicating an index under COLL 5.2.31R (Schemes replicating an index) the *scheme property* need not consist of the exact composition and weighting of the underlying in the relevant index ~~where deviation from this is expedient for reasons of poor liquidity or excessive cost to the *scheme* in trading in an underlying investment~~ in cases where the *scheme's* investment objective is to achieve a result consistent with the replication of an index rather than an exact replication.

Relevant indices

5.2.33 R (1) The indices referred to in COLL 5.2.31R are those which satisfy the following criteria:

~~(1)~~(a) the composition is sufficiently diversified;

~~(2)~~(b) the index ~~is a representative~~ represents an adequate benchmark for the market to which it refers; and

~~(3)~~(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*]

...

- 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 ...

...

- 5.4.9 G 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)]

...

- 5.6.5 R *Transferable securities* and money-market instruments held within a *non-UCITS retail scheme* must:
- (1) (a) be admitted to or *dealt* in on an *eligible* market within *COLL 5.2.10R* (Eligible markets: requirements); or
 - (b) be recently issued *transferable securities* which satisfy the requirements for investment by a UCITS scheme set out in *COLL 5.2.8R(3)(e)*; or
 - (c) be approved money-market instruments not admitted to or dealt in on an eligible market which satisfy the requirements for investment by a UCITS scheme set out in *COLL 5.2.10AR(1)*;
or

- (2) subject to a limit of 20% in value of the *scheme property* be:
 - (a) *transferable securities* which are not ~~approved securities~~ within (1); or
 - (b) ...

...

5.6.7 R ...

- (3A) The limit of 10% in (3) is raised to 25% in value of the *scheme property* in respect of *covered bonds*.

...

Investment in ~~warrants and~~ nil and partly paid securities

5.6.9 R A *non-UCITS retail scheme* must not invest in ~~warrants, and~~ nil and partly paid *securities* unless the investment complies with the conditions in *COLL 5.2.17R* (Investment in ~~warrants and~~ nil and partly paid securities).

...

- 5.6.13 R (1) A transaction in a *derivative* must be within *COLL 5.2.20R(1)* (Permitted transactions (derivatives and forwards)) and:
- (a) the underlying must be within *COLL 5.6.4R(5)* (Investment powers: general) or *COLL 5.2.20R(2)(f)* to (i); and
 - (b) the exposure to the underlying must not exceed the limits in *COLL 5.6.7R* (Spread: general) ~~and~~ *COLL 5.6.8R* (Spread: government and public securities) and *COLL 5.6.5R(2)*.

...

Risk management: ~~derivatives and forwards~~

5.6.16 R An *authorised fund manager* must use a risk management process enabling it to monitor and measure as frequently as appropriate the risk associated with a *non-UCITS retail scheme's derivatives and forwards* positions and their contribution to the overall risk profile of the *scheme*.

Risk management process

5.6.17 G ...

- (5) The risk management process should enable the analysis required by *COLL 5.6.16R* (Risk management: ~~derivatives and forwards~~) ...

...

- 5.6.23A G (1) Replication of the composition of an 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 for the purpose of *efficient portfolio management*.
- (2) The composition of an index is sufficiently diversified if its components adhere to the spread requirements in this section.
- (3) An index is a representative 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 *scheme*; this does not preclude index providers and the *scheme* from forming part of the same *group*, provided that effective arrangements for the management of conflicts of interest are in place.

...

6.3.6 G ...

Valuation and pricing		
1	...	
	(2)	...
	(2A)	<i>Schemes investing in money marked instruments <u>approved money-market instruments</u> should value such instruments on an amortised cost basis on condition that the scheme is a qualifying money market fund;</i>
		(a) <u>the <i>approved money-market instrument</i> has a residual maturity of less than three months and has no specific sensitivity to market parameters, including credit risk;</u> or
		(b) <u>the <i>scheme</i> is a <i>qualifying money market fund</i>.</u>
[Note: CESR's UCITS eligible assets guidelines with respect to article 4(2) of the UCITS eligible assets Directive]		
	...	
2	The pricing controls of the authorised fund manager	

		...
	(2)	The controls referred to in (1) should ensure that:
		...
	(i)	... ; and
	(j)	... ; <u>and</u>
	(k)	<u>the valuation of OTC derivatives is accurate and up to date and in compliance with the methods agreed with the depositary.</u>
		...
3		The depositary's review of the authorised fund manager's systems and controls
	(1)	... These checks also apply where an <i>authorised fund manager</i> has delegated all or some of its <i>pricing</i> functions to a third party <u>one or more third parties</u> .
		...
	(5)	... (and in particular the prices of <i>OTC derivatives</i> , unapproved <i>securities</i> and...
		...
...		

...

- 6.6.15 R (1) ...
- (2) The *authorised fund manager* of a *scheme* and the *directors* of an *ICVC* have the power to retain the services of anyone to assist in the performance of their respective functions, provided that:
- (a) a mandate in relation to *managing investments* of the *scheme* *property* is not given to:
- (i) ...
- (ii) ...
- (iii) ~~any other person who is not both:~~
- (A) ~~authorised or registered for the *managing of investments*; and~~

~~(B) subject to prudential supervision; unless there is an agreement in place between the FSA and the overseas regulator of the delegate ensuring adequate co-operation;~~

an authorised person operating from an establishment in the United Kingdom unless such person has a Part IV permission to manage investments; or

(iv) any other person operating from an establishment in a country other than the United Kingdom unless such person:

(A) is authorised or registered in such country for the purpose of asset management; and

(B) is subject to prudential supervision in such country;

and in addition if that person is not an EEA firm, co-operation is ensured between the FSA and the overseas regulator of that person;

...

...

6.6.16 G ...

(3) For the purpose of COLL 6.6.15R(2)(a)(iv) adequate co-operation will be ensured where the FSA has entered into a co-operation agreement of the kind referred to in article 50(4) of the UCITS Directive with the relevant overseas regulator.