

**NEW COLLECTIVE INVESTMENT SCHEMES SOURCEBOOK
(OTC DERIVATIVE REQUIREMENTS AND OTHER MISCELLANEOUS
AMENDMENTS) INSTRUMENT 2006**

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).

(1)	(2)
Glossary of definitions	Annex A
New Collective Investment Schemes sourcebook (COLL)	Annex B

Citation

- E. This instrument may be cited as the New Collective Investment Schemes Sourcebook (OTC Derivative Requirements and other Miscellaneous Amendments) Instrument 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 <i>authorised fund manager</i> acts in relation to any other <u>regulated collective investment schemes</u> 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 *depository* 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

any time, at a fair value ...

...

Risk management process

5.2.25 G ...

- (2) The *depository* 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 depository) and COLL 6.6.14R (Duties of the depository 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 *depository* 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 depository).

...

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 *depository* 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 depository)~~ COLL 6.6.4R (General duties of the depository) and COLL 6.6.14R (Duties of the depository 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);
- ...
- (7) COLL 5.5.7R (1), and ~~COLL 5.5.7R (2) and (4)~~ (Restrictions on lending of property other than money);

...

Duties of the depository 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).

...