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Financial Services Authority

Collective Investment Schemes Sourcebook Part One and Two

August 2000



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Part Three (CP62a*)

Annex: Rules and Guidance

* A full copy of the CIS Sourcebook (CP62a) is available on the FSA website (www.fsa.gov.uk).

Alternatively, paper copies can be obtained by calling the FSA orderline: 0845 675 6775, quoting reference CP62a.

The FSA welcomes responses on this consultation paper. Comments are requested by 6 October 2000. You can send your response by electronic submission using the form on the FSA's website at www.fsa.gov.uk/pubs/cp/cp62_response.html, in writing or by e-mail to:

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It is the FSA's policy to make all responses to formal consultation available for public inspection unless the respondent requests otherwise.

1 Executive summary

- 1.1 This paper sets out for comment the FSA's draft Collective Investment Schemes Sourcebook, containing requirements for the operation of UK based collective investment schemes.
- 1.2 The types of schemes that this will apply to are unit trusts and the more recently introduced open-ended investment companies. Proposals are also included in the CIS Sourcebook to extend the investment powers of open-ended investment companies, bringing them into line with the wider range of investments available to unit trusts.
- 1.3 In order for collective investment schemes to be promoted to the public they need to be authorised by the FSA and comply with its rules. There is, currently, a large amount of FSA regulatory material that applies to these schemes. Its purpose is to implement European law requirements and to provide a body of rules and guidance within which these schemes can operate. This material provides a high standard of consumer protection for those investing in collective investment schemes.
- 1.4 The FSA's short-term aim in preparing the CIS Sourcebook is to carry forward, largely unchanged in substance, this material under the new powers available to us in the Financial Services and Markets Act. Much of the regulatory material has been in place for many years, exists in different forms and has been extended and updated on a piecemeal basis. Bringing this together in the Sourcebook in the way we propose will, we believe, bring benefits, particularly in terms of understanding and compliance for those in the investment funds industry that are subject to it, without imposing any material costs. At the same time the high standard of consumer protection that the current material delivers will be maintained. We believe therefore that the approach we are adopting in rolling forward most of the existing material is the best way of achieving our statutory objectives.
- 1.5 However, we envisage that, over time, this regime of regulation will be changed to accommodate shifting consumer needs and market developments.

Some aspects of the current regulations and of the rules proposed in this Sourcebook are already under review (for example those relating to the valuation and pricing of schemes). We will also, in the future, consider the overall nature and content of the CIS Sourcebook in the light of continuing work on the development of the new regulatory approach, as outlined in '*A new regulator for a new millennium*' published by the FSA in January 2000.

- 1.6 Part Two of this consultation paper highlights specific issues on which the FSA would welcome comments. More generally, the FSA welcomes comments on all the draft rules and guidance by 6 October 2000. We will take account of the results of this consultation before publishing the CIS Sourcebook in final form.

2 Introduction

Purpose of this consultation paper

- 2.1 The purpose of this consultation paper is to set out the FSA's proposals for the CIS Sourcebook, which are intended to replace the existing regulations and guidance for regulated collective investment schemes ('CIS products') at 'N2', when the FSA assumes its full regulatory powers.

Structure of this consultation paper

- 2.2 This chapter outlines the approach the FSA has adopted in preparing the CIS Sourcebook, explains its contents in general terms, and considers some issues for the future. Chapter 3 of this Part provides general information on the structure and format of the CIS Sourcebook. Annexed to Chapter 3 is the material the FSA is required to produce to meet its statutory requirements under the Financial Services and Markets Act ('the Act'), this being:
- a compatibility statement – Annex 1; and
 - a cost benefit analysis and a statement of the powers under the Act and the ICVC¹ Regulations for the FSA to make rules and guidance – Annex 2.
- 2.3 Part Two provides narrative on specific changes the FSA proposes to make as a result of the approach adopted. Part Three is the draft CIS Sourcebook.

About the CIS Sourcebook

- 2.4 The FSA's general approach to the regulation of CIS products was outlined in '*Meeting our responsibilities*', published in August 1998. There the FSA proposed that the existing product regulation regime would be carried forward, largely unchanged, under the new legislation.

1 The term 'ICVC' is used throughout the CIS Sourcebook to describe companies that are currently known as open-ended investment companies, or 'oeics'. The acronym 'ICVC' reflects the terminology used in the draft ICVC Regulations (the Open-Ended Investment Companies (Investment Companies with Variable Capital) Regulations [2000]), published by HM Treasury in January 2000 and distinguishes an oeic authorised in the United Kingdom from other oeics. Other terms used in the CIS Sourcebook and in this consultation paper are defined in the definitions glossary of this Sourcebook.

2.5 The CIS Sourcebook is intended to meet this commitment, as a stand-alone part of the FSA Handbook. The rules in the Sourcebook will be made under the powers contained in the Act and the ICVC Regulations (which are listed in Annex 2). They will mainly apply to² : -

- managers and trustees of AUTs;
- the ACD, any other directors, and depositaries of ICVCs; and
- operators of recognised collective investment schemes.

Principles behind the development of the CIS Sourcebook

2.6 The key principles in developing this Sourcebook have been to roll forward the existing product regulation regime for regulated collective investment schemes whilst providing some additional flexibility.

Rolling forward existing regulation

2.7 In rolling forward the existing product regulation regime, the FSA has tried to ensure that the regulatory material covering CIS products has been brought together in a way that provides for:

- consolidation of the regulations for ICVCs and AUTs, where practicable and without over complication;
- alignment, where possible, between the regulations for ICVCs and AUTs; and
- rationalisation of that material.

Consolidation

2.8 Currently, Chapter VIII of the Financial Services Act 1986 (the 'FS Act') provides powers that enable the FSA to make regulations relating to regulated collective investment schemes. The FS Act limits UK schemes to AUTs. The regulations made under these powers are the Financial Services (Regulated Schemes) Regulations 1991 (the 'RSRs'). These regulations provide the detailed operating regime for AUTs authorised by the FSA.

2.9 In 1996, the Open-Ended Investment Companies (Investment Companies with Variable Capital) Regulations 1996 (the 'ECA Regulations') were made. The ECA Regulations permit onshore open-ended investment companies to be introduced, but, because they have been made under powers contained in the European Communities Act 1972, schemes are limited to those satisfying the UCITS directive.³ The ECA Regulations provide powers similar to those in the

2 To a small extent, the rules in the CIS Sourcebook also apply to auditors.

3 Undertakings for Collective Investment in Transferable Securities: EC Directive 85/611/EEC as amended by Council Directive 88/220/EEC.

FS Act for AUTs, thus enabling the FSA to make the Financial Services (Open-Ended Investment Companies) Regulations 1997 (the ‘OEIC Regulations’).

- 2.10 The RSRs and the OEIC Regulations comprise the majority of product regulation for collective investment schemes established in the United Kingdom. The powers under the Act (for AUTs) together with those that HM Treasury has proposed in the draft ICVC Regulations, are analogous to those in the FS Act and the ECA Regulations. The FSA proposes that the RSRs and the OEIC Regulations should now be consolidated into one set of rules. The CIS Sourcebook adopts this approach by putting the material into topic based chapters (see the list at paragraph 3.1 of this consultation paper).
- 2.11 In addition, guidance on certain CIS matters previously issued by IMRO and other relevant FSA guidance is reproduced in the CIS Sourcebook. Thus, the CIS Sourcebook will be a single body of rules and guidance covering the regulation of CIS products. There have been no fundamental changes in policy in this process of consolidation. Whilst doing this, the CIS Sourcebook maintains the objective of seeking to ensure a continuing high standard of protection for investors in AUTs and ICVCs and that those persons responsible for the operation of AUTs and ICVCs act in the best interests of investors.

Alignment

- 2.12 When introducing the OEIC Regulations in 1997, the FSA recognised that this would result in some aspects of the product regime for ICVCs being on a slightly different footing to that for AUTs. The FSA promised to return to the question of alignment between the two sets of regulations at a later stage. The FSA has therefore taken the opportunity in the draft CIS Sourcebook to align the RSRs with the OEIC Regulations in cases where it is desirable and practicable and does not lead to fundamental changes in policy. The main areas of alignment are highlighted in Part Two of this consultation paper.

Rationalisation

- 2.13 As part of the alignment exercise, the FSA has taken the opportunity to rationalise the existing material so that many requirements are only stated once where they apply to both AUTs and ICVCs, thereby reducing the volume of rules by about one quarter. However, this means that in a number of chapters there are some rules which will only apply to either ICVCs or AUTS. Therefore, to assist readers, at the beginning of a number of chapters, there is a table showing which rules apply to which CIS product. (The CIS Sourcebook will be available electronically and, in due course, it is hoped to offer a significant degree of functionality and navigation aids.) To assist in achieving this rationalisation, some new definitions have been adopted to cover some features that are common to both AUTs and ICVCs. Part Two of this consultation paper highlights some of the more frequently used terms.

What additional flexibility is provided?

- 2.14 After publication of the ECA Regulations, HM Treasury consulted in 1996⁴ on bringing the investment powers of ICVCs into line with the wider range of investments available to those AUTs that are not covered by the UCITS directive. Those proposals, whilst welcomed at the time, did not proceed following the change of Government in May 1997. However, HM Treasury will now be making the ICVC Regulations under powers provided in the Act, which will have the effect of bringing the investment powers into line.
- 2.15 Shortly after the 1996 HM Treasury consultation, the FSA consulted⁵ on product regulations for new categories of non-UCITS ICVCs that would have been introduced under HM Treasury's proposed legislation. The FSA's proposals were well received. The CIS Sourcebook will now include these new categories, thereby providing additional flexibility within the regulatory regime and the possibility of increased consumer choice.
- 2.16 Separately, the FSA consulted in November 1999⁶ on three product regulation matters: charging expenses to capital; changes to facilitate the extension of the Government's stamp duty exemption on conversions of AUTs to ICVCs; and changes to facilitate the introduction of stamp duty reserve tax on 'surrenders' of units or shares. The latter two issues resulted in changes to the RSRs and OEIC Regulations in January 2000⁷. Changes were not made to the RSRs or the OEIC Regulations as a result of the consultation on charging expenses to capital. The draft CIS Sourcebook includes proposed amendments in this area. Commentary on these amendments and on other rules that provide additional flexibility is contained in Part Two.

Discussions with trade associations and consumer representatives

- 2.17 In *'The Open Approach to Regulation'* policy statement published in July 1998, the FSA said it would hold informal discussions at an early stage with those likely to be directly affected by regulation. The FSA has held discussions on the CIS sourcebook with a number of bodies, including some regulatory bodies, the CIS Forum⁸, the FSA Consumer Panel and trade associations.

4 Open-Ended Investment Companies, The Next Generation, a consultation document, HM Treasury, dated November 1996 and published in December 1996.

5 Consultative Paper 108, Proposed Amendments to the Regulations for Open-Ended Investment Companies, published in May 1997, 'CP108'.

6 Consultation Paper 32, Proposed amendments to the regulations for collective investment schemes: tax related amendments, published in November 1999, 'CP 32'.

7 Release 203, The Financial Services (Regulated Schemes)(Amendment) Regulations 2000 and Release 204, The Financial Services (Open-Ended Investment Companies)(Amendment) Regulations 2000.

8 The CIS Forum is chaired by the FSA, and comprises representatives from trade associations from the investment funds industry, other regulatory bodies and consumer representatives.

Future potential change to the CIS Sourcebook

- 2.18 There are a number of significant policy issues the FSA is currently considering, which are already in the public domain and which may result in some amendment, over the next year or so, to the CIS Sourcebook. A summary of the work in progress on each of these is outlined in paragraphs 2.19 to 2.22 below.

Single pricing

- 2.19 When the FSA introduced a single pricing alternative for AUTs at the beginning of 1999, it announced that it would be undertaking a review of the single pricing regime for both ICVCs and AUTs. This review is to help determine:
- whether the system of single pricing required by the current regulations (and now reproduced in Chapter 4 of the CIS Sourcebook) should be retained, and/or whether another system or alternative systems should be provided for; and
 - the earliest practicable date on which AUTs that are dual-priced (the system for which is included in Chapter 15 of the CIS Sourcebook) should be required to adopt single pricing.

- 2.20 The FSA expects to publish its findings from this review by the end of the year.

Limited issue funds

- 2.21 In CP11⁹, the FSA outlined proposals for the introduction of limited issue funds. The large majority of responses supported the FSA's general approach. The FSA aims to produce formal proposals for consultation on this topic by the end of the year, taking into account the implications of the relevant provisions of the Act on its earlier proposals.

Amendments to the UCITS directive

- 2.22 The European Commission published in June a revised version of its two proposals to amend the UCITS directive, following receipt of the European Parliament's opinion on its original proposals. The Commission's revised proposals are expected to be considered by a Council Working Group during the current French Presidency. If an amending directive is adopted in due course, this is likely to lead to the need for some changes to the CIS Sourcebook (particularly to Chapter 5, which contains rules on investment powers of ICVCs and AUTs).

⁹ Consultation Paper 11, Limited issue and limited redemption funds, published in June 1998.

The longer term

- 2.23 In addition to the areas of policy mentioned above, the FSA will continue to keep the CIS Sourcebook under review and make proposals, as required, to amend it in the light of developments in the market and consumer needs. We will also consider whether the CIS product regulation regime might usefully be simplified by, for instance, relying more on principles rather than detailed rules. This work will be undertaken in the context of our work on developing a new regulatory approach as outlined in '*A new regulator for the new millennium*'.

Relationship with other Sourcebooks

- 2.24 The CIS Sourcebook is intended to be a stand-alone Sourcebook of material that concerns CIS product regulation. However, there is a need for sign-posting and navigational aids where a particular rule in the CIS Sourcebook impinges on, or has a relationship with, material elsewhere in the FSA Handbook, such as conduct of business rules. Chapter 1 of the CIS Sourcebook includes some general sign-posting material and other chapters refer, where appropriate, to other related parts of the FSA Handbook.

Open approach to consultation

- 2.25 This consultation paper is published in hard copy and is also available on the FSA website (www.fsa.gov.uk) where a pro forma response facility is available. The FSA is bringing the consultation paper to the attention of firms that need to comply with the CIS Sourcebook, trade associations and financial services consumers through representative consumer groups.
- 2.26 During the consultation period we will be participating in workshops arranged in conjunction with the investment funds industry.

3 Structure and format of the draft CIS Sourcebook

Structure

- 3.1 Listed below is the structure of the CIS Sourcebook. Part Two of this consultation paper reviews each chapter, by giving a description of the chapter or by outlining minor policy changes proposed.
1. Introduction – an overview of the CIS Sourcebook.
 2. Constitution – provisions relating to categories of ICVCs and AUTs, the instrument constituting the scheme and related matters (for example, share classes).
 3. Prospectus – requirements on the preparation, responsibility for, contents, availability of and changes to the prospectus.
 4. Single pricing and dealing – rules relating to the valuation and pricing, and the sale and redemption of units, for ICVCs and single-priced AUTs.
 5. Investment and borrowing powers – general and specific rules relating to investment, borrowing and efficient portfolio management for all ICVCs and AUTs.
 6. Title and transfer – rules relating to registration and transfer of units of AUTs and rules relating to plan registers of ICVCs and AUTs.
 7. Powers and duties – sets out general powers and responsibilities of firms involved in operating ICVCs and AUTs.
 8. Charges and expenses – conditions concerning charges and expenses which may be imposed on investors buying or selling units and/or on the ICVC or AUT itself.
 9. Income – how calculation and distribution of income is undertaken.
 10. Report and accounts – contents and publication of annual and half-yearly reports and accounts.
 11. Meetings of holders and related matters – provisions concerning a variety of matters, including processes relating to amending the instrument constituting the scheme, meeting requirements, e-commerce and how, under a scheme of

arrangement, the scheme property of an ICVC or AUT may become the property of other regulated collective investment schemes.

12. Special provisions for certain categories of scheme – provisions relating only to certain ICVCs or AUTs, particularly umbrella schemes.
13. Suspension – how suspensions of dealings should be dealt with.
14. Termination of ICVCs and AUTs– how ICVCs and AUTs may be wound-up, including termination of sub-funds of umbrella schemes.
15. Dual pricing and dealing – rules relating to the valuation and pricing, and the sale and redemption of units in dual-priced AUTs.
16. Application and notification – outlines the application and notification process for the authorisation and recognition of collective investment schemes.
17. Recognised schemes – sets out the information requirements for recognised schemes.
18. Fees – once agreed, this chapter will contain details of the fees for authorised or recognised collective investment schemes.

Transitional rules – rules to deal with the changeover from the old to the new regime.

CIS definitions glossary.

Format

- 3.2 Provisions relating to ICVCs are mainly contained in the draft rules before those relating to AUTs. This is for consistency and to facilitate possible future alignment of the AUT rules with the generally more flexible provisions for ICVCs.
- 3.3 As with other parts of the FSA Handbook, the material has the following characteristics:
 - *Rules* are specific binding requirements on firms.
 - *Guidance* is not binding and does not create an expectation that a firm must follow the guidance to show compliance with a rule. It may fulfil several functions, such as explain the scope of a rule, provide additional background information by fleshing out the underlying policy behind a rule, or be merely a navigational aid to the reader.
 - *Directions* reflect obligations under the Act.
 - *Defined terms* are italicised.
- 3.4 There are no evidential provisions contained in the CIS Sourcebook.

E-commerce

- 3.5 Our aim in drafting the rules has been to ensure the rules can sensibly accommodate e-commerce.

The FSA would welcome views on whether the CIS Sourcebook as a whole sits sensibly with e-commerce.

Derivations

- 3.6 This paper does not include a list of derivations of the rules and guidance for each chapter, but these are available on request from:

Collective Investment Schemes and Product Regulation Department
The Financial Services Authority
25 The North Colonnade
London E14 5HS

Transitional arrangements

- 3.7 The FSA has the power to make rules providing for transitional arrangements. These are necessary to ensure a smooth transition for firms from compliance with the existing regime to compliance with the CIS Sourcebook. The transitionals are provided at the end of the CIS Sourcebook and a commentary on them is included in Part Two of this consultation paper. We have proposed a transitional period of one year before instruments constituting the scheme must be updated. If a change to the instrument is made for another purpose during that time it must be changed to reflect the new material.

The FSA invites comment on the proposed transitional arrangements and invites firms to identify any additional relief that would be required for any rule in the CIS Sourcebook, which results from this reorganisation of existing material on product regulation.

Timetable

- 3.8 The FSA will review the CIS Sourcebook in the light of responses. The FSA Board will then make the final rules, which will be published before N2.

Compatibility with the FSA's general duties under the Act

1. This statement explains why we believe the proposed rules and guidance in this consultation paper are compatible with the FSA's general duties under section 2 of the Financial Services and Markets Act. The requirement for the FSA to make this statement is set out in section 155 of the Act.

Statutory objectives

Consumer protection

2. The provisions in the CIS Sourcebook are aimed principally at meeting the FSA's consumer protection objective.
3. The CIS Sourcebook is intended to ensure a high and uniform standard of protection for consumers in UK authorised collective investment schemes by specifying a number of features of those schemes and how those schemes are to be operated. The existing CIS regulatory regime places considerable emphasis on consumer protection and, by replicating the substance of the existing regulation, the CIS sourcebook continues this approach.
4. The FSA must have regard to four criteria specified in section 5(2) of the Act when meeting the consumer protection objective. These have been addressed in the CIS Sourcebook in the manner set out in paragraphs 5 to 10 of this Annex.
 - i. **The differing degrees of risk involved in different kinds of investment or other transaction.**
5. We have sought to reproduce the differences in the current FSA regulations for collective investment schemes, whereby requirements are tailored to the different risks presented by the current categories of authorised fund. For example, securities schemes must spread their investments with a larger

number of issuers than is required of money market schemes. Further, certain schemes (e.g. property schemes) are subject to special requirements for the valuation of their investments.

ii. The differing degrees of experience and expertise that different consumers may have in relation to different kinds of regulated activity.

6. The CIS Sourcebook, as a whole, provides a detailed operating regime for authorised funds suitable for the protection of private investors. Facilities such as the availability of different share classes in ICVCs allow these funds to be adapted for investment by different classes of consumer.
7. In addition, a number of categories of fund are permitted, whose constituent investments allow low risk vehicles (e.g. money market schemes) and higher risk vehicles (e.g. geared futures and options schemes).

iii. The needs that consumers may have for advice and accurate information.

8. These needs are met by requiring suitable information to be offered to investors to assist them in making well informed choices about investing in an authorised fund, and to keep them properly informed on the progress of their investment. Thus:
 - Chapter 3 contains requirements on the preparation, content, availability of, and changes to, an authorised fund's prospectus; and
 - Chapter 10 concerns the content and publication of annual and half-yearly reports and accounts of authorised funds.
9. These requirements are in addition to those proposed in the draft Conduct of Business Sourcebook for the information a firm must give to customers before it carries out transactions and afterwards (for example, periodic statements).

iv. The general principle that consumers should take responsibility for their decisions.

10. We propose to support this principle by requiring the prospectus for an authorised fund to set out sufficient and suitable information to enable customers to take their own view on the suitability of the fund concerned for their own circumstances. In giving effect to this principle, we need to recognise the importance of current consumer perceptions of most regulated collective investment schemes as relatively safe investments.

Other statutory objectives

11. Whilst not aimed primarily at the FSA's other statutory objectives, the rules in the CIS Sourcebook support the market confidence objective by, for example, laying down rules that are designed to ensure that consumers are treated fairly. This will encourage customers' confidence in dealing with firms who operate authorised collective investment schemes.
12. In addition the public awareness objective is supported by, for example, requiring firms to offer a detailed prospectus to prospective investors.
13. The CIS Sourcebook does not set out specific rules to address financial crime. Nevertheless certain provisions, such as those designed to safeguard the assets of a collective investment scheme, may play an ancillary role in preventing financial crime.

Matters to which the FSA must have regard when it carries out its general functions

14. Under the requirements set out in section 2(3) of the Act, in carrying out its general functions, the FSA must have regard to the specific matters set out below.
 - i. **The need to use its resources in the most efficient and economic way.**
15. We consider that, at this stage, the most efficient way of using FSA resources is by rolling forward the existing regime of regulation. The CIS Sourcebook does this in a way that consolidates and aligns, where practicable and desirable, the currently separate and extensive regulations and guidance that apply to AUTs and ICVCs. This will enable the FSA to supervise AUTs and ICVCs more efficiently and will make it easier for the FSA to make adjustments to its CIS rules and guidance, where necessary, in the future.
 - ii. **The responsibilities of those who manage the affairs of authorised persons.**
16. The CIS Sourcebook specifies the separate responsibilities of authorised fund managers and depositaries. This is necessary to implement the UCITS directive and to recognise the separate roles of manager and depositary in the operation of collective investment schemes. However, the Sourcebook gives some discretion to directors and senior managers of those firms operating authorised funds to make their own decisions on how they apportion responsibilities within those firms.

iii. The principle that a burden or restriction which is imposed on a person, or on the carrying on of an activity, should be proportionate to the benefits, considered in general terms, which are expected to result from the imposition of that burden or restriction.

17. As the CIS Sourcebook largely rolls forward existing rules and guidance, without any new burdens, we do not consider that the need for cost benefit analysis arises, as the costs involved are minimal. The new measures we propose introducing are designed to provide further flexibility.
18. On this basis, and given current consumer perceptions of the product, we consider that these measures are proportionate, while leaving open the possibility of introducing greater flexibility over time.

iv. The desirability of facilitating innovation in connection with regulatory activities.

19. The CIS Sourcebook is designed to provide firms with sufficient flexibility to develop new products and delivery mechanisms. For products, the Sourcebook introduces the ability for ICVCs to be established in a form that mirrors (apart from feeder funds) the wider range of categories of unit trust that can currently be authorised.
20. The regulations and guidance that currently exist have been modified by the CIS Sourcebook so as to accommodate e-commerce. For example, firms may supply customers with information by electronic means, where customers expect this.
21. More generally, the FSA intends to be responsive to market developments by exercising its powers under the Act and the ICVC Regulations to modify its rules. Such changes can only be made if they are consistent with FSA's statutory objectives and are justified on cost/benefit grounds.

v. The international character of financial services and markets and the desirability of maintaining the competitive position of the United Kingdom.

22. The CIS Sourcebook aims to require firms to operate authorised funds in a responsible and effective manner. It also permits a range of authorised funds to be established that can be sold internationally, including those which qualify under the UCITS directive and can be sold throughout the EEA.
23. The FSA believes that the high standard of consumer protection that these rules are designed to deliver will assist the United Kingdom to maintain and enhance its competitive position.

vi. **The need to minimise the adverse effects on competition that may arise from anything done in the discharge of those functions.**

24. The CIS Sourcebook is not expected to introduce any new restriction on competition. The present regulatory regime for collective investment schemes has not obviously restricted competition, given the number of firms competing in this rapidly expanding sector of the financial services industry and the wide choice of products available to consumers. The CIS Sourcebook should have a broadly similar effect. But we will keep the competition aspects under review, especially because the complexity of the rules for different types of firm could constitute an unintended barrier to entry.

vii. **The desirability of facilitating competition between those who are subject to any form of regulation by the Authority.**

25. In general, the rules and guidance in the CIS Sourcebook seek to ensure that firms operating similar types of AUT or ICVC are subject to the same requirements. We have also taken the opportunity which the new legislation provides to bring the range of assets in which ICVCs can invest into line with those currently available to AUTs.

Why the CIS Sourcebook is the most appropriate way for the FSA to meet its obligations

26. The need for the proposed material in the CIS Sourcebook is based on a judgement that, in order to deliver consumer protection in this context, the FSA must lay down detailed standards for the operation of authorised funds, which are appropriate and proportionate for funds that are to be provided to the general public in the United Kingdom. In some areas this detail is necessary in the absence of other appropriate legal requirements. In other areas the rules implement the requirements of the UCITS directive, but in a manner that provides reasonably comprehensive coverage of topics, thus providing clarity and certainty of operation for firms that are subject to the rules.

27. The regime of regulation contained in the CIS Sourcebook makes no significant change to the current regime. We consider, therefore, that it will provide the same high standard of consumer protection that is provided under the current regime, with minimal increase in cost. We will, nevertheless, in the light of future developments, particularly those that result from developing the new regulatory approach, as outlined in '*A new regulator for a new millennium*', return to the question of whether we should review the approach to CIS regulation contained in this Sourcebook.

Cost benefit analysis and powers available to the FSA

Introduction

1. This Annex:
 - explains why we consider that no cost benefit analysis is required; and
 - contains the powers the FSA has under the Act to make rules on collective investment schemes. These are set out in a table also showing the relevant existing powers.

Cost benefit analysis

2. The Act requires the FSA to provide a cost benefit analysis on proposed new rules. However, this is not required where any increase in cost is of minimal significance (see section 155(8) of the Act). As the CIS Sourcebook aims to roll over the existing regime, the FSA does not believe a cost benefit analysis is required. However, the following should be noted:
 - New categories of ICVC – the proposals in the CIS Sourcebook to introduce new categories of ICVC provide firms with more flexibility and will not increase costs.
 - Charging expenses to capital – the proposals in CP32 included a cost benefit analysis. The proposals in this consultation paper are not significantly changed and the FSA considers that this analysis still stands and that any cost increase is of minimal significance. Part Two of this consultation paper provides additional details.
 - Alignment of the AUT and ICVC product regulation regime – the FSA considers that the alignment proposed will enable AUTs to adopt in some areas the less prescriptive approach available to ICVCs, and will not adversely affect consumers. It will, therefore, have minimal cost implications.

- Much of the material in the CIS Sourcebook consists of a re-written version of existing material. Whilst this might incur some initial additional costs due to the extra time that users will need to familiarise themselves with the material, we believe that these will not be significant and there will be a future cost saving in terms of clarity and readability.

Powers to make rules and issue guidance

3. The following table provides details of the relevant powers under the Act enabling the FSA to make rules and issue guidance on collective investment schemes together with the existing powers:

Existing Powers	New Powers
<p>Financial Services Act 1986</p> <p>section 81</p> <p>section 85</p> <p>section 86(3)</p> <p>section 87(4)</p> <p>section 87(5)</p> <p>section 88(10)</p> <p>section 90</p>	<p>Financial Services and Markets Act 2000</p> <p>section 247 – trust scheme rules</p> <p>section 248 – scheme particulars rules</p> <p>section 264(3) – schemes constituted in other EEA States</p> <p>section 270(6) – designated territories schemes</p> <p>section 278 – rules as to scheme particulars</p> <p>section 278 – rules as to scheme particulars</p> <p>section 283 – facilities and information in UK</p>
<p>The Open-Ended Investment Companies (Investment Companies with Variable Capital) Regulations 1996</p> <p>regulation 6</p>	<p>The Open-Ended Investment Companies (Investment Companies with Variable Capital) Regulations [2000] (in draft)</p> <p>regulation 6 – FSA rules</p>

4 Detailed commentary on the draft CIS sourcebook

Introduction

- 4.1 The main purpose of this part is to highlight some of the amendments arising from the consolidation and alignment process, to the extent that these are not covered in Part One or in the explanation of each chapter in the CIS Sourcebook. The FSA hopes that readers will find this helpful in explaining how the CIS Sourcebook carries forward the RSRs and the OEIC Regulations. A detailed table of derivations and destinations is available on request from the FSA.

Definitions

- 4.2 All defined terms will be set out in the complete Handbook Glossary. The definitions glossary at the end of the draft CIS Sourcebook contains a number of defined terms that are used in the CIS Sourcebook.
- 4.3 The following definitions are particularly worth noting as they reflect the consolidation process for the RSRs and the OEIC Regulations and apply to both ICVCs and AUTs:
- *Authorised Fund*: covers both an ICVC and an AUT;
 - *Authorised Fund Manager*: is shorthand for the ACD of an ICVC and the manager of an AUT;
 - *Depositary*: includes both the depositary of an ICVC and the trustee of an AUT. ‘Trustee’ is used where the rule or guidance is applicable to an AUT only;
 - *Holder*: includes a shareholder of an ICVC and a unitholder of an AUT;
 - *ICVC*: is used to enable a distinction to be drawn between an ‘open-ended investment company’, which covers any open-ended investment company, and ‘ICVC’ which covers only a UK authorised open-ended investment company;

- *Instrument constituting the scheme*: includes both the instrument of incorporation of an ICVC and the trust deed of an AUT;
- *Issue*: relates to the issue of new shares by an ICVC and the issue of units by the trustee of an AUT and, for an AUT, replaces the term ‘create’ used in the RSRs;
- *Prospectus*: the CIS Sourcebook definition includes both the prospectus of an ICVC and scheme particulars for an AUT. CIS 3.1.2(4)G however, indicates that the use of the term ‘scheme particulars’, when preferred, is permitted;
- *Plan register*: covers both a plan register of an ICVC and a plan sub register of an AUT;
- *Sale*: refers to the sale of units of any authorised fund by an authorised fund manager acting as principal, and, for an AUT, ‘sale’ or ‘sell’ replaces the term ‘issue’ used in the RSRs;
- *Scheme Property*: replaces the definition in the RSRs of ‘property of the scheme’ but, in order to maintain consistency with the ICVC Regulations, this definition includes the distribution account for an ICVC, but excludes that account for an AUT;
- *Unit*: includes both units in an AUT and shares in an ICVC. ‘Shares’ is used where the reference is only to the shares of an ICVC;
- *Eligible institution*: this is the wider definition contained in the OEIC Regulations. Representations have been made to the FSA, which are currently being considered, to use the term ‘approved bank’ as defined in the COB Sourcebook, to replace references to eligible institution in CIS 7.6.3R and CIS 7.10.6R. This would allow a wider range of bodies to accept deposits from authorised funds, where an affected person is used. Comments are welcome on this issue.

Chapter 1 – Introduction

- 4.4 Chapter 1 provides guidance on the purpose of the CIS Sourcebook; contains an overview of the types of collective investment scheme that the CIS Sourcebook covers; includes an outline of each chapter of the CIS Sourcebook and information on related material to be included in the FSA Handbook.

Chapter 2 – Constitution

CIS 2.3.3R – UCITS obligations

- 4.5 In accordance with the UCITS directive, CIS 2.3.3(1)R prevents an authorised fund that qualifies under the UCITS directive from being transformed into a non-UCITS scheme. Subject to this, and to provide additional flexibility,

regulation 2.07.11 of the RSRs (which prohibits any AUT from changing category) has not been carried forward. This current prohibition imposes unnecessary costs where investors would not be disadvantaged by a change of category. A proposed change of category would need to be approved by the FSA.

CIS 2.5 – Units and classes of units in AUTs

- 4.6 CIS 2.5 requires any unit in an AUT to be either an income unit or an accumulation unit. The FSA expects to consider after N2 whether classes of units in an AUT should be permitted on a similar basis to the share classes permitted for ICVCs.

Chapter 3 – Prospectus

CIS 3.3.1R – False or misleading prospectus

- 4.7 Regulation 3.06 of the RSRs has been aligned with regulation 3.03 of the OEIC Regulations. Responsibility for a prospectus will, in future, rest solely with the authorised fund manager. Accordingly, under rule CIS 3.3.1R (False or misleading prospectus - requirement), an authorised fund manager is liable to pay compensation for loss resulting from a false or misleading prospectus.

CIS 3.4.2R – Changes to the prospectus

- 4.8 CIS 3.4.2R is based on regulation 3.05 of the OEIC Regulations, but has been extended to cater for changes to the prospectus of an AUT. Accordingly, certain changes to a prospectus of an ICVC or AUT can only be made if approved by the holders. This reflects re-positioning of some material that is in regulation 11.04 of the RSRs.

CIS 3.5 - Information to be contained in the prospectus

- 4.9 Rules governing the minimum content of prospectuses are at section 3.5. The requirements for ICVCs (in Schedule 1 of the OEIC Regulations) and AUTs (in Schedule 2 of the RSRs) have been combined, with clear indications where rules apply only to one type of authorised fund or the other. No other significant changes to the current regulations concerning the content of prospectuses are proposed.

Chapter 4 – Single pricing and dealing

- 4.11 This chapter replaces Part 4 of the OEIC Regulations and Part 4A of the RSRs. In addition, it includes a slightly revised version of the guidance issued by IMRO¹⁰ relating to valuation of authorised funds (see CIS 4.8.4G).
- 4.12 CIS 4.8.2G explains that a valuation undertaken by reference to a time that is not a valuation point will not cause that time to become a valuation point.

Chapter 5 – Investment and borrowing powers

Chapter 5 - General

- 4.13 Chapter 5 sets out rules relating to the investment and borrowing powers of all authorised funds, and will replace Part 5 of the OEIC Regulations and Part 5 of the RSRs.
- 4.14 In line with the proposals in CP108, ICVCs will be able to invest in the wider range of assets that are currently available for investment by AUTs. However, this does not extend to feeder funds (for pension purposes). CP108 explained that these were being reviewed by HM Treasury and the FSA in relation to certain pension developments. The document, issued in July, by HM Treasury and the Department of Social Security on Individual Pension Accounts raises the question of whether there will be any need for feeder funds for pension purposes when IPA's are introduced. HM Treasury and the FSA will give further consideration to feeder funds for pension purposes in the light of the consultation on the HM Treasury/DSS document.
- 4.15 In general terms, the existing powers of, and limitations on, investment by ICVCs and AUTs remain unchanged from the existing regulations. However, some of the rules in Chapter 5 have been drafted on the basis of those proposed in CP108, thus providing more flexibility in some respects. In particular, the rules listed below have been drafted on the basis of CP108:
- CIS 5.4.3R: deletion of the limitation on property scheme investment in unlisted securities¹¹, as the 10% rule for investment by property schemes in unlisted property related assets is covered in CIS 5.8.3(6)R.
 - CIS 5.5.3(2)(e)R, CIS 5.6.7 R, CIS 5.7.7 R and CIS 5.8.7 R: permit money market schemes, futures and options schemes, geared futures and options schemes and property schemes to invest up to 5% in value of the scheme property in other regulated collective investment schemes that are money market schemes.
 - CIS 5.5.5(6) R, CIS 5.6.3(6) R and CIS 5.7.6(3)R: increases the limit (from £500,000 to £1 million) below which spread requirements for

10 IMRO Rulebook Chapter 2, Appendix 7.6(1)(e) Valuation of Authorised Unit Trust Schemes under SETS and Valuation of UK Open-ended Investment Companies under SETS.

11 Currently in regulation 5.10.4 of the RSRs.

scheme property of money market schemes kept as cash on deposit are dis applied.

- CIS 5.8.4(1)R: permits investment in land or buildings situated in any country or territory identified in the prospectus for this purpose.

CIS 5.2.9R – Transferable securities and derivatives

- 4.16 So as to reflect the nature of a particular investment more accurately, CIS 5.2.9(4)R requires an investment which can be either considered as a transferable security or a derivative to be treated as a transferable security or as a derivative, according to the effect of that investment.

CIS 5.2.13R – Significant influence for ICVCs

- 4.17 This rule, which mirrors paragraphs 1 and 2 of regulation 5.17 of the OEIC Regulations, has been extended to apply to all types of ICVCs. Paragraph 3 of that regulation has become CIS 5.2.15R.

CIS 5.2.14R – Significant influence for managers of AUTs

- 4.18 CIS 5.2.14R replaces Rule 7.7 (Significant Influence over Company Management) of Chapter 2 of the IMRO Rulebook and Rule 2.19 of the Financial Services (Conduct of Business Rules) 1990. This rule is now restricted to the manager of an AUT. A breach of this rule must be rectified in accordance with CIS 7.10.3R (Duties of manager and trustee - investment and borrowing powers).

CIS 5.2.15R - Concentration

- 4.19 The RSRs prevent an AUT from holding more than 10% of the share capital of a body corporate with partial, occasional or full voting rights¹². The FSA proposes to delete these restrictions for AUTs and align the concentration rules for AUTs with those applicable to ICVCs. Accordingly, CIS 5.2.15R mirrors regulation 5.17.3 of the OEIC Regulations, but has been extended to apply to all categories of authorised fund, except for concentration in units in a collective investment scheme, which is disapplied for feeder funds and fund of funds schemes. The acquisition of the voting share capital of a body corporate will, however, be restricted by CIS 5.2.14R (for AUTs) or CIS 5.2.13R (for ICVCs).

CIS 5.3.3R – Eligible markets

- 4.20 In order to ensure, as far as practicable, consistency between ICVCs and AUTs, CIS 5.5.3R proposes that the authorised fund manager (after consultation with the depository and (for ICVCs) any other directors) decides

12 Regulation 5.14 of the RSRs.

which securities or derivatives markets are eligible markets when dealing in the authorised fund's scheme property. Under the existing OEIC Regulations, all directors are required to decide which markets are eligible. The FSA hopes that restricting this responsibility to the authorised fund manager will be a useful simplification.

- 4.21 As a consequence of this simplification, the FSA has to replace regulation 5.06.2e of the OEIC Regulations, which requires the instrument of incorporation to contain a provision for the directors to choose the eligible markets. In order to make the requirements for ICVCs and AUTs consistent, the FSA proposes that each instrument must contain a provision similar to the eligible markets provision for trust deeds of AUTs. CIS 2.2.6(6)R contains this requirement. Transitional rule 1.9 provides directors of ICVCs one year to update the instrument of incorporation. Such a transitional is not required for AUTs.

CIS 5.4.2R– Securities schemes: general

- 4.22 CIS 5.4.2(5) R allows the spread requirements for a securities scheme to be disapplied until the securities scheme has reached a value of £1 million. The FSA (then SIB) carried this rule over in 1991 from the 1988 Regulations¹³. Given the passage of time since that level was introduced, it has been suggested to the FSA that a higher figure (say £2 million) would be more appropriate. The FSA would welcome views on this.

CIS 5.5.4R – Investment in government and public securities

- 4.23 The FSA no longer wishes to restrict, by means of a list, the choice of non-member State countries available for investment in government and public securities. Accordingly, proposed rule CIS 5.5.4 R would permit investment in government and public securities of the government of any country, provided that, where an authorised fund holds more than 35% of those securities issued or guaranteed by one single government, certain conditions are fulfilled (see sub-paragraphs (3), (4) and (5) of CIS 5.4.4 R).
- 4.24 The FSA believes that this amendment would end the current distortion between investment in fixed interest securities issued by non-governmental issuers of a particular non-member state country, which is currently permitted, and investment in securities issued or guaranteed by governments of that same country, which may only be permitted for a limited amount. The FSA considers that this policy change would impose no additional costs. The FSA is currently considering whether criteria should be established, perhaps by guidance, in the light of which ACDs and depositories could reach a view on the appropriateness of issuers of government and public securities. The FSA

13 The Authorised Unit Trust Scheme (Investment and Borrowing Powers) Regulations 1988 (SI 1988/284), as amended by The Authorised Unit Trust Scheme (Investment and Borrowing Powers) (Amendment) Regulations 1989 (SI 1989/1437).

would welcome any views on whether such criteria should be established and by whom.

- 4.25 A transitional rule (rule 1.8) would give authorised funds that wish to take advantage of this additional flexibility a one year period before having to update their instruments constituting the scheme.

CIS 5.4.6R – Investment in warrants and in nil and partly paid securities

- 4.26 CIS 5.4.6(1)R makes a slight amendment to existing provisions in order to clarify the FSA's policy that an authorised fund manager should take into account the contents of the authorised fund's portfolio, including other warrants forming part of the scheme property, when applying the reasonably foreseeable test in CIS 5.4.6(1) R for the purpose of calculating the spread requirements.

CIS 5.6 - Futures and options schemes

- 4.27 Except for CIS 5.6.12 R (Derivatives covering derivatives), the rules regarding cover are largely similar in the sections on futures and options schemes and on efficient portfolio management (CIS 5.13). It has been suggested that these provisions should not be repeated in this way, but covered in full in one section and, so far as possible, by cross-references in the other. Views are invited on whether this approach is desirable.

CIS 5.6.3R – Futures and options schemes: general

- 4.28 The provision allowing the scheme property of a futures and options scheme to contain gold has been retained. As far as the FSA is aware, no futures and options schemes have made use of this possibility. As investment in other commodities is not otherwise permitted for authorised funds, the FSA would welcome views on whether this provision should be retained.

CIS 5.8 – Property schemes

- 4.29 The proposed rules for property schemes investment are based on those proposed in CP108. The FSA will, after N2, undertake a review of the investment powers of these schemes. This would include consideration of whether the rules could be adapted to permit property schemes to invest in property jointly with others and whether any alternative provisions to ensure liquidity should be put in place.

Chapter 6 – Title and transfer

- 4.30 Without making any substantive policy changes, Chapter 6 includes rules on the register of unitholders (currently in Part 6 of the RSRs) and amalgamates the provisions in Part 6 of the RSRs and Part 7 of the OEIC Regulations on plan registers.

Chapter 7 – Powers and duties

Powers and duties - General

- 4.31 Given the differences between AUTs and ICVCs, the FSA does not consider that there is much scope for harmonising many of the rules that deal with the duties of authorised fund managers, directors, depositaries and trustees. Accordingly, Sections CIS 7.2 to CIS 7.6 relate exclusively to powers and duties in respect of an ICVC, and sections CIS 7.7 to CIS 7.11 relate exclusively to powers and duties in respect of an AUT. The FSA has, however, taken the opportunity to slightly amend a number of the rules for reasons of clarity and consistency.

CIS 7.6.1R - Committees and appointments and CIS 7.10.4R - Delegation

- 4.32 Chapter 7 does not contain an equivalent of 6.10.6 and 6.10.8 of the OEIC Regulations nor of 7.15.5 and 7.15.6 of the RSRs. Those regulations relate to the responsibility of the authorised fund manager or the depositary for persons whose services they have retained, or to whom they have delegated functions. This area is now subject to the rules and guidance in Chapter 3 of the Senior management arrangements, systems and controls ('SYSC'), which will form part of Block 1 of the FSA Handbook¹⁴. In particular it should be noted that SYSC 3.2.3G contains guidance on safeguards relating to the choice and supervision of delegates. SYSC 3.2.4G makes it clear that these safeguards are also relevant to external delegation ('outsourcing'). It also states that a firm cannot contract out of its regulatory obligations and that, under Principle 3, a firm should take reasonable care to supervise the discharge of outsourced functions.

Chapter 7 – Annex 7 G

- 4.33 This Annex originates from Appendices 7.6(1)(a) and 7.6(1)(c) of Chapter 2 of the IMRO Rulebook, which both deal with guidance on pricing and valuation for authorised funds.
- 4.34 In 1998, an IMRO Working Party undertook a review of these appendices, in the light of developments since its publication, including a review on the events surrounding two Morgan Grenfell AUTs. Annex 7G, which contains a consolidated draft of both appendices, reflects the results of this work. The most important changes to the existing guidance are (references are to Annex 7G):
- 2 (8) - proper controls on the valuation of unquoted securities;
 - 2 (10) - authorised fund manager should notify the depositary of trades on unapproved securities on the same day;

14 Rules and Guidance within High Level Standards. See also FSA Policy statement, High level standards for firms and individuals, Issues arising out of CP35 and CP26, issued in June 2000.

- 3 (3) – depositary should carry out reviews of an authorised fund manager’s pricing systems on a risk based approach;
- 3 (4) – prices of unapproved securities should be verified more frequently;
- 3 (7) – the depositary should review the sources of prices.

4.35 Views are invited on this redraft.

Chapter 8 – Charges and expenses

Chapter 8 – General

4.36 The provisions in Chapter 8 maintain the current distinctions between the charging structures of ICVCs and AUTs. Chapter 15 contains rules relating to charges payable upon the acquisition or disposal of units in a dual-priced AUT.

CIS 8.6 – Umbrella schemes

4.37 The current distinction between ICVCs and AUTs on the charges related to exchange of units in one sub-fund of an umbrella scheme for units in another sub-fund has been maintained. The rule on exchange of units in a dual-priced umbrella scheme is in Chapter 15 (CIS 15.4.12 R).

CIS 8.13.1R and 8.18.1R – Allocation of payments to capital or income

4.38 The scope of what charges may be allocated to the capital property of an authorised fund has been extended to permit the authorised fund manager to make such an allocation in the proportion it considers appropriate. This reflects the outcome of consultation on the amendments proposed in CP32. Appropriate investor protection safeguards are provided by requiring a meeting of holders in an authorised fund that is neither an ‘income’ fund nor a fund with equal emphasis on income and capital growth (‘balanced funds’). In authorised funds that are income or balanced funds, a period of notice is required to be given to holders before changing the prospectus to reflect the change in the allocation policy. There do not appear to be any resulting cost increases as a result of permitting this increased flexibility.

Chapter 9 – Income

Chapter 9 – General

4.39 Chapter 9 has, to a large extent, aligned the RSRs relating to accounting periods, income allocation, distribution and equalisation with the OEIC Regulations. The FSA does not expect this to have major implications on a manager’s or trustee’s systems.

CIS 9.2.3R – Annual allocation of income

- 4.40 CIS 9.2.3(2) R (Annual allocation of income) increases the threshold below which the directors of an ICVC or the trustee need not transfer income property of the authorised fund to the distribution account from £5 (for ICVCs) and £1 (for AUTs) to instances where the average of the allocations of income to holders is less than £10. It is hoped that this will provide useful additional flexibility.

CIS 9.2.7G – Income equalisation

- 4.41 The OEIC Regulations do not require income equalisation but the instrument of incorporation may provide for it. The FSA proposes to introduce the same regime for AUTs in CIS 9.2.7 G. For this purpose, CIS 2.2.4(1)(l)G sets out what must be provided for in the trust deed, if a manager decides to provide for income equalisation. Transitional rule 1.7 provides the transitional arrangements on the change from the old regime in the RSRs to the new regime. The transitional would allow managers one year to continue to pay an amount for income equalisation on the basis currently required by the RSRs, without the need for a change to the trust deed. If, after this one year, no provision for income equalisation is included in the deed, payment of equalisation must stop (until a provision is incorporated in the deed). Provided there is appropriate disclosure in the prospectus¹⁵ and in the reports of the AUT¹⁶, the FSA does not consider that such a change needs to be approved by a meeting of unitholders or be subject to a notice period.

CIS 9.2.8R – How distributions may be made

- 4.42 The FSA has retained CIS 9.2.8 R, which reflects regulation 9.09 of the RSRs. Sub-paragraphs (1) to (5) of CIS 9.2.8 R set out, in some considerable detail, how distributions may be made in AUTs. As this degree of detail is not laid down for ICVCs, the FSA doubts whether all this material is necessary. The FSA would therefore welcome views on whether the detail in CIS 9.2.8 (1) – (5)R is essential.
- 4.43 Regulation 9.10 of the RSRs requires distribution statements to be sent out. Due to the alignment process mentioned above, the FSA proposes to delete this requirement.

Chapter 10 – Report and accounts

Chapter 10 - General

- 4.44 Chapter 10 contains rules and guidance on the preparation and publication of annual and half- yearly reports on authorised funds. For reasons of

15 CIS 3.5.5(4)R (Distributions).

16 CIS 10.4.2(11)R (Report of the directors of an ICVC or report of the manager of an AUT).

consistency between ICVCs and AUTs and for reasons of clarity, the FSA proposes to introduce broadly similar requirements for ICVCs and for AUTs. To that effect, Chapter 10 reflects the draft regulations on which the FSA consulted in CP36¹⁷, but these are modified, where relevant, to cater for AUTs. In addition, as proposed in CP36, this chapter includes rules making compliance with the SORP for ICVCs (which the FSA plans to issue shortly) mandatory.

- 4.45 Under the Accounting Standard Board's code of practice for SORPs, the FSA will be expected to keep the SORPs under regular review. The SORP for AUTs¹⁸, issued in January 1997 is due for review. Whilst doing so later in the year, the FSA will also consider whether a combined SORP for authorised funds should be issued.

CIS 10.3.3R and CIS 10.3.4R - Annual and half-yearly reports

- 4.46 Regulation 9.01.2b. and 5b. of the OEIC Regulations require each report of an ICVC umbrella scheme to contain an aggregation of the accounts of the ICVC's sub-funds. As part of the alignment process, and to ensure, as far as practicable, comparability of reports of ICVCs and AUTS, the FSA now proposes to introduce a similar requirement for reports of AUT umbrella schemes (in CIS 10.3.3(2)(b) R and CIS 10.3.4(2)(b) R).

CIS 10.4.7R - Report of the trustee

- 4.47 CIS 10.4.7 R , which originates from Schedule 3, Part V of the RSRs, and which requires the trustee to report annually to unitholders on the conduct of the manager, has been amended slightly to introduce a materiality test. The FSA believes that this would make a trustee's compliance with this requirement more practicable and would provide a more useful report for investors. A similar materiality test has been introduced for the report of the depositary of an ICVC (in CIS 10.4.6 R).

Transitional arrangements

- 4.48 Transitional rule 1.11 provides that for a period of one year after the coming into effect of the CIS Sourcebook, directors or managers may continue to operate on the basis of the RSRs or the OEIC Regulations.

17 Consultation paper 36, Statement of Recommended Practice, Financial Statements of Authorised Open-Ended Investment Companies', published by the FSA in December 1999, CP36.

18 Statement of Recommended Practice, Financial Statements of Authorised Unit Trust Schemes, issued by IMRO in January 1997.

Chapter 11 – Meeting of holders, amendments to the instrument constituting the scheme, schemes of arrangement and service of notices and other documents.

Chapter 11 - General

4.49 Chapter 11 reflects Parts 11 and 15 of the RSRs and Part 10 of the OEIC Regulations. Apart from those outlined below, no major changes have been made. Amendments to the prospectus is covered in Chapter 3. Therefore, the FSA has not reproduced regulation 11.04 of the RSRs in this chapter.

CIS 11.2.8R and CIS 11.3.12R – Special meaning of shareholder and unitholder

4.50 To facilitate CREST settlement, CIS 11.2.8R and CIS 11.3.12R are intended to ensure that the rules relating to notices of meetings of holders and voting rights are compatible with regulation 34 of the Uncertified Securities Regulations¹⁹. The FSA does not consider that this amendment will have any adverse investor protection implications. The FSA will, at a later stage, consider whether it is necessary to make any other changes to the rules in the CIS Sourcebook to accommodate CREST.

CIS 11.5 – Schemes of arrangement

4.51 CIS 11.5.2 R is intended to replace and simplify existing provisions in the RSRs and in the OEIC Regulations relating to amalgamations, reconstructions and conversions.

CIS 11.6 – Service of notices and other documents

4.52 As explained in Part One, the FSA's aim has been to ensure that the rules in this sourcebook can sensibly accommodate e-commerce. Section 11.6 contains the main facility for this. In particular, CIS 11.6.1 R and CIS 11.6.2 R would give those responsible for the operation of authorised funds the flexibility to deal with holders and/or other persons through electronic or other means. In that respect, a signature will be taken to include an electronic signature as well as a traditional signature. Draft regulation 85 of the ICVC Regulations also relates to the service of documents. The FSA is liaising with HM Treasury to avoid conflict between that regulation and CIS 11.6. Some amendment to CIS 11.6 may result from this.

19 The Uncertified Securities Regulations 1995 (1995 No 3272).

Chapter 12 – Special provisions for certain categories of scheme

Chapter 12 - General

- 4.53 This chapter amalgamates and rationalises special provisions for AUTs (from Part 12 of the RSRs) and ICVCs (from Part 11 of the OEIC Regulations). There are, however, no substantive policy changes.
- 4.54 Special provisions for umbrella schemes have been grouped into section 12.5. Table 12.1 of the RSRs has been removed as this table has been difficult to interpret and is incompatible with the less prescriptive approach adopted for umbrella companies in the OEIC Regulations. However, Table 12.5G has been introduced to assist readers by providing a reminder of the provisions in the CIS sourcebook that make particular reference to umbrella schemes.

CIS 12.5.1R– Qualification for authorisation

- 4.55 In CP108, the FSA proposed that an ICVC which is an umbrella scheme and which contains sub-funds that operate as either geared futures and options schemes or property schemes, should not contain other categories of sub-fund. This proposal was designed to recognise that geared futures and options schemes and property schemes posed a greater risk of insolvency than other categories of authorised fund, and that mixing those types of sub-fund with other categories in an umbrella scheme would be undesirable, as the assets of solvent sub-funds might be used to discharge the liabilities of insolvent sub-funds. Commentators on CP108 welcomed the FSA's approach. Therefore, CIS 12.5.1(2) R requires that where geared futures and options or property sub-funds exist in an umbrella ICVC, every other sub-fund in the umbrella ICVC must be of the same type in order for the umbrella scheme to qualify for an authorisation order.

Chapter 13 – Suspension

- 4.56 The RSRs (Part 13) and OEIC Regulations (Part 12) are consolidated within Chapter 13, but there are no changes of note.

Chapter 14 – Termination of schemes

Chapter 14 - General

- 4.57 This chapter rolls over existing material on termination for AUTs and OEICs and contains no substantive policy changes. The provisions listed in paragraphs 4.58 to 4.62 below should, however, be noted.

CIS 14.2 – Winding up a solvent ICVC

- 4.58 Section CIS 14.2 deals with winding up of a solvent ICVC and is derived from regulations 12.02 to 12.10 of the OEIC Regulations. The summary table at

the beginning of the chapter provides a guide to the stages in the process of winding up.

CIS 14.3 – Termination of a sub-fund of an umbrella ICVC

- 4.59 Section CIS 14.3 deals with termination of ICVC sub-funds and is derived from regulations 12.11 to 12.18 of the OEIC Regulations.
- 4.60 Whilst many of the provisions in this section mirror those in section 14.2, the FSA hopes that this will provide for greater clarity when sub-funds are to be terminated.

CIS 14.4 – Winding-up of an AUT

- 4.61 Section CIS 14.4, on the winding up of AUTs, is derived from regulations 13.03 to 13.05 of the RSRs.

CIS 14.5 – Schemes that are not commercially viable

- 4.62 Section CIS 14.5 reflects the FSA's current practice on receiving requests for the winding-up of authorised funds that are not commercially viable.

Chapter 15 – Dual pricing and dealing

- 4.63 It is not generally the FSA's intention to make major changes to the current regime of dual pricing available to AUTs, pending the current review referred to in Part One of this consultation paper. However, the FSA proposes to align minor aspects of the dual-pricing regime with that for single-pricing, the most important of which are:

- CIS 15.3.5(4)R and CIS 15.3.7(7), relating to issue and cancellation, and CIS 15.4.8(3)R, relating to redemption, do not require the current one day settlement period applicable to money market schemes and securities schemes that are invested more than 50% in government and public securities. The period would in future be four days, as for other categories of scheme; and
- CIS 15.8.3R -Valuation of scheme property: as for ICVCs and single-priced AUTs (see paragraph 4.12), CIS 15.8.3 (2) R makes it clear that for dual-priced AUTs, a valuation undertaken at a time that is not a valuation point will not cause that time to become a valuation point. This will include, for example, a valuation undertaken for effecting a scheme of arrangement, or for transfers of pension funds. The FSA is not convinced of the need for sub-paragraphs (4) to (6) of CIS 15.8.3 R, as sub-paragraph (2) of that rule, as amended, will make it sufficiently clear that a valuation, undertaken for the purposes other than the determination of the price, is permitted and will not become a valuation point. Views are invited on whether (2) can effectively replace sub-paragraphs (4) to (6) or whether their retention is essential.

Appendix CIS G – Correction of box management errors

- 4.64 This appendix sets out guidance on the recording, reporting and the correction of box management errors, and on the payment of compensation for some of those errors. It also provides some guidelines on controls an authorised fund manager and depositary should put in place relating to box management. This guidance, which is based on a draft prepared by an IMRO Working Party, is intended to replace Appendix 7.6(1)(b) (Correction of unit trust box management errors) and Appendix 7.6(1)(d) (Correction of UK Open-Ended Investment Companies box management errors) of Chapter 2 of the IMRO Rulebook.

Chapter 16 – Application and notification

- 4.65 Chapter 16 provides guidance to applicants seeking authorisation of AUTs or ICVCs and to those making notifications in respect of offshore schemes, (i.e. those seeking recognition in the United Kingdom). It also provides guidance about the process of seeking approval for significant changes to existing authorised funds. The guidance provides signposts to the relevant legislation and explains how to obtain the appropriate forms and guidance notes published by the FSA. It also sets out the timescales within which the FSA expects to process the various types of application or notification.
- 4.66 Guidance on independence of depositaries of ICVCs, and trustees and managers of AUTs is at the end of Chapter 16. This guidance replaces the current guidances on independence²⁰ contained in Chapter 5 of Volume 3 of the FSA Rulebook. The FSA has decided to include this guidance in Chapter 16 as that chapter covers issues that arise in the authorisation process, and, under both the Act and the ICVC Regulations, the FSA has to be satisfied on the question of independence before it can issue an authorisation order.
- 4.67 Regulation 71 of Part IV of the ICVC Regulations requires the FSA to maintain a register of ICVCs. Procedures are being put in place for this and more details will be released during the consultation period.

Chapter 17 – Recognised schemes

- 4.68 This chapter replaces Part 14 of the RSRs and also incorporates material from Part 3 and Schedule 2 (prospectus material) of the RSRs that applies to recognised schemes. The intention is to consolidate all relevant material into one chapter dealing with schemes established overseas. The rules and guidance in this chapter indicate the processes involved in notifying the FSA so that overseas schemes can gain recognition under the Act (under sections 264, 270, or 272 of the Act) and can be marketed in the United Kingdom.

²⁰ SIB Guidance release 1/90 - Independence of Trustees/Managers of Unit Trusts: Section 78(2) of the Financial Services Act 1986, issued in February 1990 and SIB Guidance Release 1/97 – Independence of Depositaries of Open-Ended Investment Companies, issued in January 1997.

Continuing requirements for maintenance of scheme documentation and notifications to the FSA are also covered.

- 4.69 Unlike the position under the FS Act, recognised schemes will no longer have the facility to market in the United Kingdom under SRO rules. Instead, all recognised schemes will be subject to the FSA rules on financial promotion contained in the Conduct of Business Sourcebook. The FSA is not intending to issue a guidance release along the lines of that issued in July 1989²¹.

Chapter 18 – Fees

- 4.70 Details about the proposed FSA fee structure are contained in FSA Consultation paper 56, published in June 2000²². When finalised, it is intended that CIS fees will be set out in Chapter 18.

Transitionals

- 4.71 The rules in the schedule of transitionals are designed to ensure a smooth transition from the OEIC Regulations and the RSRs to the regime in the CIS Sourcebook. In general terms, instruments constituting the scheme do not have to be amended immediately to reflect the new regime, but can remain unchanged until one year after the CIS Sourcebook comes into effect. However, if any change is made for other purposes to the instrument constituting the scheme during that year, then the instrument must be updated at that time to reflect the new material.
- 4.72 Specific transitionals are provided for the changes to the provisions on income equalisation (for AUTs, see paragraph 4.41), on investment in government and public securities (see paragraph 4.25), on eligible markets (for ICVCs, see paragraph 4.21) and on the preparation of reports and accounts (see paragraph 4.48). Transitional rule 1.11 would permit certain AUTs to invest in ICVCs that are non-UCITS schemes without the need for an immediate change to their trust deeds.

21 SIB Guidance Release 3/89 – Marketing in the United Kingdom, Guidance for Operators of Recognised Collective Investment Schemes, issued in July 1989.

22 FSA Consultation paper 56, The FSA's post-N2 fee-raising arrangements.

