Investment Management Association

# Authorised Funds:

# A Regulatory Guide

March 2012

## INTRODUCTION

This is a document designed for use by investors who are considering investment in a UK authorised fund and who wish to understand in more detail the UK regulatory regime for authorised funds. Unlike unregulated schemes, the operation of UK authorised funds is governed by comprehensive regulation, of which this Guide provides a summary.

Authorised funds are regulated by the Financial Services Authority (FSA) and must adhere to the detailed regulatory requirements set out in the FSA's Collective Investment Schemes Sourcebook (COLL), which covers matters such as operating duties and responsibilities, investment and borrowing powers, and investor relations.

In addition, the FSA Handbook includes eleven key Principles for Business, one of which requires Managers of authorised funds to pay due regard to the interests of their customers and to treat them fairly. To reinforce this Principle, the FSA has issued a large amount of material on "Treating Customers Fairly (TCF)", including specific guidance for Managers. The FSA requires all Managers to be able to demonstrate that they are consistently delivering fair outcomes to investors and that senior management are taking responsibility for ensuring that both the Manager and its staff at all levels are delivering the outcomes required by TCF through establishing an appropriate culture throughout the business.

Authorised funds enable individuals to invest in a diversified portfolio of securities and certain other assets. Investors' contributions are pooled and invested on their behalf by professional investment managers.

The UK governance structure for authorised funds is built around the segregation of duties between the Manager and the Depositary. This segregation of duties is the most fundamental element of investor protection provided by authorised funds. The Depositary has oversight responsibilities for the Manager's activities in a number of key areas and is also responsible for the safeguarding of the assets of the authorised fund. This is explained further in section 2 (see below).

This paper is in four sections:

- Section 1 provides a summary of the types of authorised fund structures available;
- Section 2 explains the governance structure of UK funds;
- Section 3 provides further information about the operation of UK funds;
- Section 4 describes how funds are taxed in the UK.

Authorised Fund Managers are invited to use this document, supplemented with fund and management company specific information, to inform potential investors, or to use relevant parts of this document within their own literature.

## DEFINITIONS

| | |
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| **ACD** | Authorised Corporate Director of an OEIC |
| **AMC** | Annual Management Charge |
| **AUT** | Authorised Unit Trust |
| **CIS** | Collective Investment Scheme |
| **COBS** | FSA's Conduct of Business Sourcebook |
| **COLL** | FSA's Collective Investment Schemes Sourcebook |
| **DATA** | Depositary and Trustee Association |
| **Depositary** | Except where expressly stated, this is a generic term used to describe both the Depositary of an OEIC and the Trustee of an AUT |
| **FAIF** | Fund of Alternative Investment Funds |
| **Feeder UCITS** | A UCITS which invests at least 85% of its assets in the units of a single master UCITS |
| **FOS** | Financial Ombudsman Service |
| **FSA** | The Financial Services Authority, the regulator of the UK Financial Services industry |
| **FSCS** | Financial Services Compensation Scheme |
| **FSMA** | Financial Services and Markets Act 2000 |
| **ICVC** | Investment Company with Variable Capital, also known as an OEIC |
| **KIID** | Key Investor Information Document |
| **Manager** | Except where expressly stated, this is a generic term used to describe both the Manager of an AUT and the ACD of an OEIC |
| **Master UCITS** | A UCITS which has at least one unitholder which is a feeder UCITS |
| **NAV** | Net Asset Value |
| **NURS** | Non-UCITS Retail Scheme. A CIS that does not comply with the requirements of the UCITS Directive, but which is subject to the |

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| | same level of investor protection and can be marketed within the UK to retail investors |
| **OEIC** | Authorised Open-ended Investment Company, also known as an ICVC |
| **OEIC Regulations** | OEIC Regulations 2001, as amended from time to time |
| **PAIF** | Property Authorised Investment Fund |
| **REIT** | Real Estate Investment Trust |
| RMP | Risk Management Process |
| **SDRT** | Stamp Duty Reserve Tax |
| **TEF** | Tax Elected Fund |
| **TER** | Total Expense Ratio |
| **Trustee** | Trustee of an AUT |
| **OTC** | Over-the-counter – i.e. not dealt on a recognised investment exchange |
| **QIS** | Qualified Investor Scheme |
| **SORP** | Statement of Recommended Practice |
| **UCITS** | Undertakings for collective investment in transferable securities. A CIS that complies with the UCITS Directive |
| **UCITS Directive** | Directive 2009/65/EC relating to undertakings for collective investment in transferable securities (UCITS), as amended from time to time |

## SECTION 1 - TYPES OF AUTHORISED FUND

### 1.1 *What are the different legal structures?*

At present, two types of legal structure are permitted under UK law: incorporated funds, known as Investment Companies with Variable Capital (ICVCs), or more commonly referred to as Open-Ended Investment Companies (OEICs); and authorised unit trusts (AUTs). They are both types of Collective Investment Schemes (CIS) under the Financial and Services and Markets Act 2000 (FSMA 2000).

### a. *What is an Authorised Unit Trust?*

An AUT is a CIS under which the scheme property (the assets) is held in trust for the investors, by the Trustee, who has legal ownership of the scheme property. An AUT is different from a company in that it does not have its own legal personality.

The investors have a direct beneficial economic interest in the scheme property and are the legal owners of the units. The Trustee has a duty of oversight over the activities of the Manager. The Manager operates the scheme. Any economic benefits to be gained from the AUT, such as dividends, are collected and distributed by the Trustee to the investors in the fund.

An AUT is constituted by a Trust Deed, entered into by the Manager and the Trustee, who must be completely independent of each other. The Manager and the Trustee must be authorised by the FSA and there are regulations governing AUTs, which are directly applicable to both the Manager and Trustee, and enforced by the FSA.

### b. *What is an Open-Ended Investment Company?*

Open-Ended Investment Companies (OEICs) are different from AUTs in that they have a corporate structure and are similar to a company. Under the OEIC Regulations, such companies are required to have at least one director; if the company has only one director, it must be a corporate director authorised under the FSMA and is referred to as the Authorised Corporate Director (ACD). In practice, OEICs have only an ACD.

The ACD is responsible for the operation of the OEIC. The OEIC must appoint a Depositary to safeguard the property of the scheme and provide oversight of the scheme's operation. The shareholders in an OEIC will have an indirect beneficial interest through their shareholdings in the OEIC.

OEICs may be structured as single funds or as umbrella funds with several sub-funds. The sub-funds are separately managed, charged, accounted for and assessed for tax.

OEICs may also offer multiple share classes, which are designed to meet the needs of different types of investors. For more information about share classes, please see section 3.6 "Share Classes".

**c.** ***Does it matter which I choose?***

The regulations governing AUTs and OEICs are identical other than in relation to a small number of technical areas where Company Law or Trust Law so dictates. The Manager of an AUT and the ACD of an OEIC are subject to identical requirements and obligations, as are Trustees and Depositaries. Indeed, in practice, the same companies are both Trustee and Depositary, and a number of Managers run both AUTs and OEICs. Also, the two structures, and income or gains received by investors, are taxed in the same way.

Until recently there was no segregation of liabilities between the different sub-funds of an umbrella OEIC. For example, if an umbrella OEIC contained one UK Equity and Bond Income fund and one Japanese Smaller Companies fund, should the Japanese Smaller Companies fund collapse with liabilities exceeding the value of its assets, creditors could have a claim on the assets of the UK Equity and Bond Income fund. Therefore, investors in one sub-fund might bear the risk of the other sub-fund collapsing. This is known as contagion risk. The likelihood of an OEIC collapsing is small due to the investment and borrowing limits placed on funds under the COLL rules and the likelihood of contagion is miniscule. Nevertheless, Managers are required to disclose the risk of contagion in the Prospectus and periodic reports.

HM Treasury has worked with IMA to develop a "protected cell" regime for UK OEICs. This regime was introduced on 21 December 2011. The regime provides in law that the assets of each sub-fund belong exclusively to that sub-fund, ring-fencing them from the other sub-funds within the umbrella OEIC and from the umbrella OEIC itself. Should a sub-fund collapse, the assets of the other sub-funds within the umbrella OEIC will not be used to meet the liabilities of the collapsed sub-fund. This will offer even greater protection for investors within an OEIC.

For umbrella OEICs authorised on or before 20 December 2011 ("existing OEICs"), any new contracts entered into must be consistent with the principle of segregated liability. Existing OEICs have a transitional period of two years (with the possibility for an extension of one year with the FSA's permission) to renegotiate existing contracts so as to become consistent with the principle of segregated liability.

Umbrella OEICs authorised from 21 December 2011 will be protected cell companies from the outset.

## 1.2 *What are the different categories of authorised funds?*

There are three different categories of authorised funds – Undertakings for Collective Investment in Transferable Securities (UCITS), Non-UCITS Retail Schemes (NURS) and Qualified Investor Schemes (QIS).

### a. *What is a UCITS?*

UCITS are investment funds that have been established in accordance with the EU UCITS Directive, which was first adopted in 1985. The Directive allows a fund that has been registered in one EU Member State to be freely marketed in any other Member State, subject to the fund first being authorised in its home state and completing a notification procedure through its home state regulator. There are various types of assets that can be held within a UCITS, with prescriptive rules on investment and borrowing, covering eligible investments (e.g. securities, money market instruments, derivatives), eligible markets and quantum of exposure (e.g. investment, counterparty risk). These rules provide diversification, limit leverage and control risk, but do not constitute a "no failure" regime. All returns are related to the risk taken. The rules on the controlling of risk acknowledge this and that risk cannot be eliminated.

### b. *What is a NURS?*

Non-UCITS Retail Schemes (NURS) are funds that do not comply with all the conditions to which UCITS are subject and therefore cannot be marketed across the EU. NURS can invest in a wider range of eligible investments (e.g. real estate) and there are slightly less restricted borrowing rules.

### c. *What is a QIS?*

QIS are available only to experienced investors who meet certain qualifying conditions. These investors are generally prepared to accept a higher degree of risk in their investments, or have a higher degree of experience and expertise, than investors in UCITS and NURS. Accordingly, they are subject to less prescriptive rules as regards investment and borrowing powers.

### d. *What are the eligible investments in which a NURS, a UCITS and a QIS can invest?*

The table below provides a summary.

| | UCITS – EU Market | NURS- UK Only | QIS |
|---|---|---|---|
| **Permitted investments** | • Shares<br>• Gilts/bonds<br>• Warrants<br>• Deposits<br>• Depository receipts | • All UCITS permitted investments<br>• Direct property<br>• Gold (up to 10%)<br>• Unregulated schemes/funds | • All UCITS permitted investments<br>• Direct property<br>• Precious metals (gold, silver, platinum) |

| | | | |
|---|---|---|---|
| | • Cash<br>• Debentures<br>• Approved Debentures<br>• Units in other investment funds<br>• Derivatives<br>• Investment Trusts<br>• Government and public securities<br>• Money market instruments<br>• Forward contracts<br>• Index tracking funds | (up to 20%)<br>• FAIFs can invest up to 100% in unregulated schemes | • Unregulated schemes/funds<br>• QIS<br>• Loans<br>• Rights under a stakeholder pension scheme<br>• Commodities |

The COLL rules place certain restrictions on funds in terms of the proportion of the capital property of the fund that may be invested in assets of any description. See section 3.2f "Investment and Borrowing Powers" for more information.

## SECTION 2 - FUND GOVERNANCE

### 2.1 *What laws and regulations apply directly or indirectly to authorised funds?*

There are four levels of law and regulation that apply directly or indirectly to funds: European legislation; UK legislation; FSA regulation (rules and guidance); and the CIS' own constitutional documents. These form a hierarchy of law and rules that at each level are progressively more detailed.

### a. *What is the main European legislation for funds?*

At the European level the UCITS Directive governs regulation of certain types of funds. It identifies the Manager and Depositary and assigns certain responsibilities to each. UK regulation imposes additional requirements. For example, under UK regulation, Depositaries have a significantly wider oversight role, both as set out in the various legislative and regulatory provisions which attach to the roles, and the general law duty when acting as a fiduciary. In addition, the Manager and Depositary must be in different groups. Therefore, there is full independence between the Trustee and Manager of an AUT, and between the Depositary and the ACD. This increases the level of protection afforded to investors.

### b. *What is the main UK legislation?*

In the UK, the main legislation is the Financial Services and Markets Act 2000 (FSMA 2000), which sets out the FSA's responsibilities, how a Manager may apply for authorisation of a fund and who may act as a Depositary. The OEIC Regulations are also relevant for OEICs, and Trust Law for AUTs.

### c. *What are the FSA regulations?*

Authorised funds are subject to FSA rules and guidance that are directly related to the operation of the fund itself. They transpose the UCITS Directive and provide essential material to complement the corporate code for OEICs. There are further rules that govern the activities of the Manager and Depositary, which are contained in a number of the FSA's Sourcebooks and Manuals, such as COLL (the Collective Investment Schemes Sourcebook), COBS (the Conduct of Business Sourcebook) and SYSC (Senior Management Arrangements, Systems and Controls).

### d. *Tell me more about the FSA's role*

Funds must be authorised by the FSA before they can be sold to the general public. To gain authorisation, the Manager must submit an application form to the FSA including various documents, such as a draft copy of the Instrument of Incorporation (for OEICS), or the Trust

Deed (for AUTs), a solicitor's certificate stating that the Instrument of Incorporation or Trust Deed complies with the relevant rules under FSMA 2000 or OEIC Regulations as appropriate, the Prospectus, the KIID, the Simplified Prospectus or Key Features Document, and a three-year business plan.

The Manager and Depositary must be UK firms authorised by the FSA to operate authorised funds. In the case of a UCITS, it is also possible for the Manager to be an EEA UCITS management company.  Such a company also needs to be authorised by the FSA for the purpose of managing a UK UCITS. The appointed independent auditor must also be appropriately experienced and qualified.

### e. *What documentation governs the fund Manager?*

Each authorised fund has its own constitutional documentation, a Trust Deed in the case of an AUT and an Instrument of Incorporation in the case of an OEIC.  These documents detail the features, powers and rules governing each authorised fund in broad terms (and essentially incorporate the regulations).  Day-to-day operating rules are then set out in the Prospectus of each authorised fund, including detailed investment objectives, the investment policy for achieving those objectives, details of each share class (e.g. differing fee scales) etc.  While many of the detailed terms of the Prospectus and other constitutional documents are set by the Manager within certain parameters, or on the basis of choices set out within FSA regulations, both the fund's constitutional document and Prospectus contain the detailed layer of requirements.

### f. *Who are the key parties involved in the governance of authorised funds?*

The authorised fund governance structure in the UK is built around the segregation of duties between the Manager and Depositary.  The FSA authorises (or recognises) both the Manager and the Depositary, and the fund itself.

Both Managers (except in the case of a UCITS where the Manager is an EEA UCITS management company) and Depositaries are regulated in the UK by the FSA and are subject to requirements under the Approved Persons Regime and conduct of business rules (COBS).  In addition, although both are permitted to delegate certain activities to third parties, they retain accountability for the operation of the fund.

In the case of a UCITS where the Manager is an EEA UCITS management company, supervisory responsibilities are split between the FSA and the home member state of the EEA UCITS management company.

## g. *Tell me more about the Approved Persons Regime*

Under the FSMA, those persons fulfilling what are considered to be controlled functions within authorised firms, including within Managers (except in the case of a UCITS where the Manager is an EEA UCITS management company) and Depositaries, must first be approved by the FSA as fit and proper before they can undertake that function. They must also comply with the FSA's Statement of Principles and Code of Practice for Approved Persons.

In assessing the fitness and propriety of a person, the FSA will examine their honesty, integrity and reputation, competence and capability and financial soundness.

In the case of a UCITS where the Manager is an EEA UCITS management company, the requirements relating to the organization of that management company are governed by the rules of its home state regulator.

## h. *What are the key responsibilities of the Manager?*

The Manager is responsible for the day-to-day management of the authorised fund. Although the Manager may delegate some of its activities to other parties, the Manager is held responsible by regulation. The Manager must comply with a set of rules designed to make the operation of the authorised fund fair and the Manager accountable.

Both the Manager and the Depositary have fiduciary obligations to investors, a concept that has come down through Trust Law, CIS Regulations and FSA Principles. Regulations attempt to codify and measure performance of that fiduciary obligation, but the core principle is that both the Manager and the Depositary must act in the best interest of the investors. This principle is central to the nature of the relationship between the authorised fund, its operators and its investors.

## i. *What are the responsibilities of the Depositary?*

The Depositary has oversight responsibilities for the Manager's activities in a number of key areas such as unit pricing, dealing, portfolio valuation and in the adherence to investment and borrowing power restrictions. The Depositary is also responsible for the safeguarding of the assets of the authorised fund. This separation of the management of the fund's assets from their ownership is the most fundamental element of investor protection provided by authorised funds.

The Depositary also has a responsibility for protecting the interests of incoming, outgoing and continuing investors. Whilst not having a direct responsibility for the Manager's activities, the

Depositary must take reasonable care to ensure that the Manager is properly discharging its own responsibilities. This is not the case for other mass retail market savings products such as deposits, savings account, insurance products or structured products.

Depositaries are, by market choice, subsidiaries or divisions within large banking groups (although regulation does not require them to be so). In practice they represent a significant resource of professional, well-qualified people, supported by significant IT, processing and specialist resources.

### j. *Are there any other parties involved in the governance arrangements of authorised funds?*

Independent auditors play an important role for authorised funds, as do standing independent valuers, who are required to value any real estate property held by the fund.

### k. *What is different about the UK governance structure?*

The UK's authorised fund governance regime is more detailed and strict than is required under the UCITS Directive in that it places a number of additional responsibilities upon Depositaries and requires Managers and Depositaries to be completely independent. This independence assists in the avoidance and management of conflicts of interests, which are likely to be more numerous where both the Manager and the Depositary are part of the same group of companies.

Also, Depositaries are required to undertake a wide variety of oversight activities and are subject to extensive conduct of business rules and other regulatory requirements; this distinguishes the UK from competing jurisdictions. The evidence suggests that it provides a more robust investor protection framework.

### l. *How else are investors protected by the UK governance structure?*

In the UK, the regulator, the FSA, has the power to require a Manager and/or Depositary to compensate an authorised fund in the event of a finding against the Manager and/or Depositary. It also has the power to fine those entities and to fine or ban individuals in those companies. In addition, authorised fund management is covered by the Financial Ombudsman Service ("FOS") and the Financial Services Compensation Scheme ("FSCS"). The FOS deals with investor complaints and can require a Manager to compensate an investor in the event of it finding against the Manager. The FSCS deals with investor compensation in the event that the Manager is in default and cannot compensate the fund or its investors for any amounts required by the FOS or the FSA (note that the default of the Manager does not impact the assets of the fund, which are quite separate from the Manager's own assets).

## SECTION 3 – FUND OPERATIONS

### 3.1 Information for investors

In the UK, there are rules to ensure that investors have access to up-to-date detailed information about a fund both prior to and after choosing to invest. These rules both enable an investor to participate in the decisions made on key issues concerning the fund and ensure that they are sent regular and relevant information.

#### a. *What is the instrument constituting the fund?*

This is the Instrument of Incorporation for an OEIC or the Trust Deed for an AUT. The instrument sets out the terms of the fund's constitution, its name, location and investment objectives, and rules about the internal management of the fund. The purpose of this document is to inform and protect investors and to ensure that holders of different classes of units or shares within the CIS are treated fairly. The instrument also sets out the powers and limitations of the fund and shows how it will be managed, providing a benchmark for those with oversight responsibilities to ensure that the Manager operates the fund as intended. All current and potential investors must be able to obtain a copy of the Instrument free of charge and on request.

#### b. *What is a fund Prospectus?*

Under UK regulation, every Manager is required to provide comprehensive information to help both investors and their advisors make a balanced and informed decision about any authorised fund prior to investing. This information is contained within the Prospectus. The Prospectus contains details on the fund's investment objectives and operation, and the persons responsible for operating the fund. It also contains details about the fund's investment policy, investment and borrowing restrictions, eligible markets, valuation and pricing policies, all expenses that are deductible from the fund's assets and any dilution levy/adjustments arrangements. The Manager must ensure that the Prospectus does not contain any provision which is unfairly prejudicial to the interests of any investors within the fund and that it is reviewed frequently and kept up-to-date. All current and potential investors must be able to obtain a copy of the Prospectus free of charge and on request.

#### c. *What are KIIDs and Simplified Prospectuses?*

The UCITS Directive requires each UCITS to provide a KIID, which replaces the Simplified Prospectus. All UCITS authorised from 1 July 2011 must produce a KIID. UCITS authorised before that date are required to replace their simplified prospectuses with KIIDs by 1 July 2012. UK authorised funds that are not UCITS can choose to produce either a KIID, a Simplified

Prospectus or a Key Features Document (see below). This could change following the introduction of the Packaged Retail Investment Products (PRIPs) initiative, which is intended to introduce a consistent disclosure regime for all retail investment products in Europe.

The UCITS Directive requires that, for each UCITS it operates, a Manager must produce and publish a KIID (or Simplified Prospectus until 1 July 2012) in a written format. In certain circumstances it can be provided in some other durable medium. The Directive also prescribes very precisely the content of the KIID and Managers must ensure that the document includes all such information as is required to enable an investor to make an informed decision about whether or not to invest in the scheme. In addition, the Manager must ensure that the KIID is regularly reviewed and must revise it immediately on the occurrence of any material change. In any event the KIID must be updated annually.

### d. *What is a Key Features Document?*

Some years prior to the introduction of the Simplified Prospectus, in order to improve the provision of information to investors, the UK regulator introduced the Key Features Document. The requirement to provide a Key Features Document applied not only to funds, but to all "packaged products". Following the introduction of the Retail Distribution Review this requirement will apply to all UK "retail Investment Products", which covers more than "packaged products". This document was intended to provide potential investors with more focussed information about the fund. The FSA required all investors to be supplied with a copy in either a paper or electronic format.

NURS may opt to adopt the KIID or continue to provide the Simplified Prospectus instead. However, a number continue to provide the Key Features Document.

### e. *Are investors entitled to receive any reports about the fund?*

In the UK, there are both legal and regulatory requirements for authorised funds to provide annual and interim reports to investors. These reports enable both current and potential investors, and their advisers, to obtain regular updates on the financial position of the fund. The requirements state that a Manager must publish the annual report and accounts within four months of the end of the fund's annual accounting period and the interim, or half-yearly, report and accounts within two months of the interim accounting date. The regulations also detail who is responsible for preparing the reports, the information that must be contained within these reports, their timing and their availability. Both reports must be made available in a detailed document, termed the Long Report, and a briefer, more user-friendly document termed the Short Report.

## f. *What information is contained within the Short Report?*

The annual Short Report must contain information regarding the fund's investment activities and performance during the period to which it relates. This information enables investors to form a view as to where the portfolio is invested and to what extent the portfolio has changed over the period in question. The Report must contain a comparative table to enable investors to view the performance record of the fund over the last five calendar years, or over the whole period for which it has been in existence, if less than five years. Any events that have had a material impact on the size of the fund, or changes of objective that could have affected the fund's performance, are also detailed.

## g. *What information is contained within the Long Report?*

The annual Long Report must contain the accounts for the annual accounting period, which must be prepared in accordance with the requirements of the Statement of Recommended Practice for Authorised Funds (SORP).

The Long Report also contains a comparative table, as explained above. Additionally, a report by the fund's Manager, Depositary and independent Auditor should be included. The Manager's report must contain information regarding the objectives of the fund, the policy and strategy pursued for meeting those objectives, and a review of the investment activities during the period in question.

The Depositary's report must contain a statement as to whether, in any material respect, the following have not been carried out in accordance with the rules and, where applicable, the OEIC Regulations and instrument constituting the fund: the issue, sale, redemption and cancellation of units; the calculation of the price of the units and the application of the fund's income; and whether the investment and borrowing powers and restrictions applicable to the fund have been exceeded.

The Auditor's report must confirm whether, in the Auditor's opinion, the accounts have been properly prepared in accordance with the SORP, the COLL rules and the instrument constituting the fund. In addition, it should include a statement as to whether the accounts give a true and fair view of the net income, the net gains or losses on the fund's assets for the annual accounting period in question, the financial position of the fund as at the end of that period, and whether proper accounting records have been kept and are consistent with the accounts.

The content of the half-yearly Long Report differs in that it need not contain a comparative table or Depositary's report. As the interim accounts are not subject to audit, no Auditor's report is included either.

## h. *What happens when a change is to be made to the fund?*

There are various rules and guidance to help a Manager determine how changes it is proposing to make to a fund should be treated and, as a consequence, how investors should be notified of these changes. Some changes require prior approval from the FSA, such as a change of Manager or Depositary, or a change to the instrument constituting the fund. Others require prior approval to be obtained from the investors in the fund. Under the regulations, Managers are obliged to consider each type of change or event on a case-by-case basis to determine the material impact on the fund and on its investors. The materiality of the impact will determine whether the change is to be treated as a pre- or post-notifiable, significant or fundamental change. This, in turn, will dictate the way in which the investors in the fund are informed of the change.

## i. *Tell me more about the types of changes that can be made to a fund*

Fundamental Change

A fundamental change is a change or event which: changes the purpose or nature of the scheme; materially prejudices a unitholder; alters the risk profile of the scheme; or introduces a new type of payment out of the fund's assets. Examples are a change in investment policy or objective, a change to the characteristics of a fund, perhaps to distribute income annually rather than monthly, or the introduction of limited redemption arrangements. In such circumstances, the regulations state that the Manager must hold a meeting of unit/shareholders to obtain their prior approval for the proposed change. There are rules that govern when and how investors should be notified of such a meeting.

In the majority of cases, a motion (resolution) is put to the meeting and is resolved by vote on a show of hands unless, either before or on a declaration of the result of a show of hands, a vote by poll is demanded. On a show of hands, every unit/shareholder who is present at the meeting has one vote. However, in a poll, each unit/shareholder has voting rights according to the value of the units or shares that they hold as a proportion of the total value of all the units/shares in issue at the date selected by the Manager prior to serving notice of the meeting. Extraordinary resolutions are required for certain matters and, in such cases, a majority of 75% of the total number of votes cast is required in order for the resolution to be passed. However, investors should be aware that there are a number of different contractual arrangements in place that could affect the way in which they are able to exercise their right to vote. This information will be detailed in the fund's Prospectus.

Significant Change

A significant change is one which is not deemed to be fundamental, but which: affects the unitholders' ability to exercise their rights in relation to their investment; would reasonably be expected to cause the unitholder to reconsider their investment in the fund; results in any increased payments out of the fund's assets to certain parties. In such circumstances, a minimum of 60 days' notice must be provided to investors to enable them to make an informed decision about whether or not they wish to stay invested in the fund. A significant change requires the Manager to provide prior written notice to unitholders.

Notifiable Change

Notifiable changes are those that are reasonably likely to affect the fund, or have already affected the fund. In such instances, the Manager must inform unitholders about these changes in an appropriate manner and timescale, which will be dependent on the nature of the event. Such changes may include a change to the time of the valuation point or a significant political event that has impacted the fund or its operation, and are beyond the Manager's control. Notification in such instances would take the form of immediate written notification, publication of the information on the company's website, or the information being included in the next Long Report of the fund. The Short Report would also contain details of these changes. For minor changes that are deemed to be post-notifiable, Managers will normally communicate these to investors by detailing them post-event in the half-yearly Short Report. For those changes which are deemed to be pre-notifiable, separate circulars will be issued.

## 3.2 Investment and Borrowing Powers

### a. *Are there limits regarding investment and borrowing powers for funds?*

Subject to FSA rules, a Manager is required to ensure that a fund meets certain minimum standards regarding the type of property in which it may be invested, the proportion of the capital property of the fund that may be invested in assets of any description and the transactions that are permitted within the fund. The instrument constituting the scheme and the Prospectus may further influence these criteria, within the regulatory restrictions. There are also limits regarding the amount of borrowing that may be undertaken.

There are different limits for UCITS and non-UCITS retail schemes (NURS) and for QIS. These limits are designed to ensure a sufficient spread of risk through diversification of the investment portfolio and are generally set as a percentage of the fund property. Maximum limits are set for various classes of investment asset such as: transferable securities (shares, debentures, government and public securities, warrants and certificates representing certain securities), approved money market instruments, units in CIS, derivatives and forward transactions, and deposits. In the case of transferable securities, the regulations make a distinction between approved securities, which are dealt on an eligible market, and unapproved securities, which are not (for more information about unapproved securities please see section 3.2c “Tell me more about the general investment and borrowing powers for UCITS and NURS”). The Manager is responsible for ensuring that, taking into account the investment objectives and policy of the fund as stated in the most recently published Prospectus, the property of the fund provides a prudent spread of risk.

### b. *Tell me more about eligible markets*

For the purpose of the rules, any market in the European Economic Area (EEA) is deemed to be eligible for investment and/or dealing by a fund if it is regulated, operates regularly, and is open to the public. Any market outside the EEA may be deemed to be eligible if it satisfies a number of criteria, such as: the market is regulated, it operates regularly, it is recognised by an overseas regulator, it is open to the public and it is adequately liquid.

The Manager is responsible for deciding the eligibility of a market and will undertake a Market Due Diligence Review in order to demonstrate the appropriateness of a market for investing and/or dealing in the fund. The Manager must then consult with the Depositary to ensure that the Depositary is satisfied that the Manager has taken all reasonable steps to ensure that the market is eligible. The Depositary must also be satisfied that adequate custody arrangements can be provided for the assets that are dealt in and on that market.

### c. *Tell me more about the general investment and borrowing powers for UCITS and NURS*

Approved transferable securities and money market instruments

*UCITS*

For UCITS, there are limits in terms of the percentage of the total value of the fund’s assets that may be invested in approved transferable securities and/or money market instruments issued by a single body. A UCITS may not invest more than 5% of its assets in transferable securities or money market instruments issued by a single body, although this limit can be increased to 10% per single body provided the total value of such holdings over 5% do not exceed 40% of the total value of the fund. This is referred to as the 5/10/40 rule. It means that a UCITS must invest in 16 assets or more (four holdings of up to 10% each and 12 holdings of up to 5% each).

For UCITS that track an index (tracker funds), these limits differ in that a maximum of 20% may be invested in a single body, and under exceptional circumstances, this may be increased to 35%.

For covered bonds, up to 25% of the fund's assets may be invested with a single body, provided the total value of such holdings over 5% do not exceed 80% of the total value of the fund.

*NURS*

A NURS may not invest more than 10% of the total value of its assets in transferable securities or money market instruments in a single body. Under the 5/10/40 rule (described above), this means that a NURS must invest in 10 assets or more (ten holdings of up to 10% each).

In the case of tracker funds, this limit may be increased to 20%. Even under exceptional circumstances, NURS are not permitted to increase this limit above 20%.

For covered bonds, up to 25% of the total value of the fund's assets may be invested with a single body.

Unapproved securities

A UCITS may invest a maximum of 10% of the total value of a fund's assets in unapproved securities (please see section 3.2a "Are there limits regarding investment and borrowing powers for funds?"), with the same maximum 5% limit applicable in terms of the percentage of the fund's assets that may be held with a single body.

NURS may invest a maximum of 20% of the total value of a fund's assets in unapproved securities.

Nil and partly paid securities

Both UCITS and NURS may invest in a transferable security or an approved money-market instrument on which a sum remains unpaid, provided that any required payment at a future date (a call) can be paid without breaching the FSA rules regarding investment and borrowing powers.

Deposits

A fund is permitted to invest a maximum of 20% of the total value of its assets in deposits with an approved bank, provided the deposit can be withdrawn on demand and matures in no more than 12 months.

For NURS, the rules state that a maximum of 20% in value of the fund's assets may be deposited with a single body.

Derivatives

UCITS may use derivatives for the purpose of hedging a fund's exposure to certain investments, assets and markets, as well as for investment purposes. The derivative must be appropriate to the fund's stated investment objective. Derivative positions will be either approved (subject to a due diligence review and performance of the transaction on an eligible derivatives market) or over-the-counter (OTC) (an off-exchange transaction which is subject to tighter restrictions under the FSA rules).

The maximum permitted exposure to any one counterparty in an OTC derivative transaction must not exceed 5% of the total value of the fund's assets, although this limit is increased to 10% where the counterparty is an approved bank.

The maximum permitted exposure for a NURS to any one counterparty in an OTC derivative transaction must not exceed 10% of the total value of the fund's assets.

For more information about derivatives, please see section 3.2i "Tell me more about derivative exposure" below.

Collective Investment Schemes (CIS)

For UCITS other than feeder UCITS not more than 20% of the total value of the fund's assets may be invested in any single CIS. In addition, a UCITS must not invest in units in a CIS (also known as the second scheme) unless the second scheme meets a number of criteria set out in the FSA rules, and provided that no more than 30% is invested in second schemes that meet a further set of criteria. A Feeder UCITS is required to invest at least 85% of its assets in the units of its master UCITS.

A NURS may invest a maximum of 35% in units of a second scheme subject to set criteria under the FSA rules.

Government and Public Securities (GAPS)

GAPS include loan stocks, bonds or other instruments creating or acknowledging indebtedness issued by local and national governments as well as specified international bodies of which any EU Member State is a member.

Where no more than 35% of the total value of the fund's assets are invested in GAPS issued by a single body there is no limit on the spread. For example, this means that a fund could invest 35% of its assets in a single UK gilt issue. However, a fund may invest more than 35% in GAPS issued by any one body provided that no individual position exceeds 30% of the total value of the fund's assets and provided the fund holds a minimum of six GAPS in total issued by any issuer. Under such circumstances, the Manager must consult with the Depositary and agree that the issuer is one which is appropriate and in accordance with the investment objectives of the fund. The Manager must also ensure that the most recently published Prospectus and the instrument constituting the scheme disclose the name of the individual states, local authorities, or public international bodies in whose issues the fund will invest more than 35%.

These limits are applicable to both NURS and UCITS.

Borrowing

A UCITS is permitted to borrow money for use by the fund, provided it will be repaid out of the scheme property and does not conflict with any restrictions on borrowing that may have been included in the fund's Instrument of Incorporation. Any such borrowing is permitted purely on a temporary and infrequent basis and must not exceed 10% of the total value of the fund's assets on any day. Prior consent for any borrowing must be obtained from the Depositary, or for periods of borrowing that may exceed three months.

For NURS, the same 10% borrowing limit applies. However, there is no restriction on the length of time for which a NURS may borrow.

### d. *Are there any other limits to which a UCITS fund is subject?*

Yes; authorised funds are subject to regulations regarding significant influence and concentration.

In terms of significant influence, public companies often seek the views of investing institutions, such as authorised fund managers, when conducting business. These institutions often provide much of a company's capital requirements and share either similar, or the same, long-term objectives. As a result, there are occasions where this close professional relationship could be deemed to influence the decisions made by the public company. To ensure that a UCITS would not be in a position to affect the running of company in which it invests, there are certain limits in place.

In the case of an OEIC, it must not control 20% of more of the voting shares of any one company. In the case of a Manager of AUT, the Manager must ensure that the total of all positions held for its AUTs does not equate to or exceed more than 20% in total of voting shares of any one company.

The concentration rules require that a UCITS must not acquire more than: 10% of the non voting shares of a company. 10% of the debt securities issued by any single body; 25% of the units in a CIS; or 10% of the approved money-market instruments issued by any single body.

### e. *Are NURS subject to these same significant influence and concentration limits?*

No. NURS are not subject to the regulations regarding significant influence and concentration.

### f. *Tell me more about investment and borrowing powers for QIS*

Managers must ensure that, taking into account the investment objectives and policy of the fund as stated in the most recent Prospectus, the QIS provides a prudent spread of risk for investors. There are no investment limits in terms of the assets in which the fund may invest. However, a QIS is permitted to borrow up to 100% of the net value of the scheme property, provided adequate arrangements are in place to ensure that any borrowings can be repaid on demand.

The table below sets out all investment and borrowing limits that are applicable to UCITS, NURS and also to QIS funds. Please also see the table in section 1.2d regarding eligible investments and paragraph d above regarding significant influence limits for UCITS.

| Category | Sub-category | UCITS | NURS | QIS |
|---|---|---|---|---|
| **Permitted investments** | Unapproved securities | Maximum 10% | Maximum 20% in unapproved securities and unregulated schemes | Permitted – no limit |
| | Collective Investment Schemes (CIS) | Ability to hold non-UCITS and non-NURS extremely limited. UCITS and NURS can be held only where they are themselves subject to 10% maximum | Maximum 20% in unregulated schemes (outside of UCITS and NURS schemes subject to risk and liquidity requirements) and unapproved | Ability to hold non-UCITS and non-NURS subject to adequate due diligence being undertaken |

| | | | | |
|---|---|---|---|---|
| | | investment in other CIS | securities. Subject to 15% maximum investment in other CIS | |
| | Property (immovables) | Not permitted unless indirectly via property securities, REITs, index based derivatives, all of which are subject to strict criteria | Permitted both directly and indirectly | Permitted both directly and indirectly |
| | Commodities | Not permitted unless indirectly via ETCs, certain commodity ETFs and index based derivatives, all of which are subject to strict criteria | Gold permitted (up to 10% of scheme). Otherwise as for UCITS. | Permitted – no limit |
| | Short positions | Permitted via cash settled derivatives only | Permitted as for UCITS | Permitted – no limit |
| Diversification Limits | Transferable securities – active funds | 5/10/40 rule applies | Maximum 10% in single transferable security | Permitted – no limit |
| | Transferable securities – schemes replicating an index | Up to 20% in a single body, 35% in exceptional circumstances | Permitted as for UCITS | Permitted – no limit |
| | Government and Public securities | 100% from a single body, provided at least 6 different issues and no more than 30% in any one issue | Permitted as for UCITS | Permitted – no limit |
| | CIS | No more than 20% in any one CIS unless the UCITS is a Feeder UCITS, which must invest at least 85% of its assets in units of its Master UCITS. | Maximum 35% in any one CIS | Permitted – no limit |
| | Deposits | Maximum 20% in any single body | Permitted as for UCITS | Permitted – no limit |
| | Property | N/A | Maximum 15% in any one property at purchase (25% subsequently) | Permitted – no limit |
| | Derivatives | Underlying must be aggregated with | Permitted as for UCITS | Permitted – no limit |

| | | | | |
|---|---|---|---|---|
| | | direct exposures, except for index-based derivatives (subject to index meeting certain requirements) | | |
| Concentration Limits | CIS | No more than 25% of any single CIS | Permitted – no limit | Permitted – no limit |
| | Equities | Must not hold more than 10% of non-voting shares | Permitted – no limit | Permitted – no limit |
| | Debt/money-market | No more than 10% issued by any one body | Permitted – no limit | Permitted – no limit |
| Derivatives | Purpose | Permitted for both hedging and investment purposes | Permitted for both hedging and investment purposes | Permitted for both hedging and investment purposes |
| | Market gearing | Permitted up to 100% on a 'commitment basis', subject to long positions being available to use as cover. Additional gearing possible for more sophisticated' funds that use VaR to monitor derivatives exposure. | Permitted as for UCITS | Permitted – no limit |
| Counterparty Exposure | OTC Derivatives (Exchange traded derivatives deemed to be free of counterparty risk) | 10% (where counterparty is an approved bank). Ability to net off collateral (subject to conditions) | Permitted as for UCITS | Permitted – no limit |
| | Transferable securities | Maximum 20% from the same group | Permitted – no limit | Permitted – no limit |
| | Overall | 20% (sum of OTC, transferable securities and deposits) | Permitted – no limit | Permitted – no limit |
| Borrowing | | Temporary borrowing only, up to a limit of 10% | Permitted as for UCITS, except for property funds, where 20% of the portfolio can be up to 100% mortgaged | Permitted up to 100% of the net value of the scheme property |

## g. *What are the rules regarding stock lending?*

The regulations enable funds to use stock lending in order to generate additional income, with either no risk, or a low level of risk, to the assets held by the fund. There are certain criteria that must be met before such a transaction may be entered into. For example, the Manager must obtain prior approval from the Depositary that the terms of the agreement and the nature of the collateral are acceptable. The counterparty must also be an approved person under the FSA regulations and approved by HMRC under the Income and Corporation Taxes Act.

## h. *Are the limits any different for FAIFs?*

FAIFs are funds that invest in “alternative” investment funds. A FAIF may be a NURS or a QIS. For NURS that operate as FAIFs, the rules regarding investment and borrowing powers are more relaxed as regards the types of CIS in which they may invest. There are additional investor protection safeguards, though. In particular, there are additional due diligence rules. As with all funds, the Prospectus and instrument constituting the scheme will outline the investment powers of the fund and may also restrict the assets in which the fund may invest.

## i. *Tell me more about derivative exposure*

The UCITS Directive provides, through the use of derivatives, for a fund to adjust its exposure to the market. UCITS are allowed to use derivatives for investment purposes as well as for efficient portfolio management (EPM), depending on the investment policy and objective of the fund. When using derivatives for the purpose of EPM, the Manager must ensure that a number of set criteria are met, including the aim of reducing risk and cost for investors. In addition, their use should aim to generate additional capital or income for the fund, whist remaining consistent with the risk profile of the fund and the COLL rules regarding risk diversification. The use of EPM techniques may enable the Manager to gain exposure to certain assets or currencies as an alternative to buying or selling the individual assets or currencies. In addition, derivatives can be used to manage market risk in relation to the securities held within the fund by hedging out their exposure to price fluctuations.

As a result, a risk management framework is required to ensure that a UCITS can effectively manage the risks posed by derivative use and not create risks that create a liability greater than the value of the UCITS. Specifically, the UCITS Directive requires a Manager to employ a risk management process that enables it to monitor and measure, at any time, the risk of positions and their contribution to the overall risk profile of the portfolio.

The global exposure resulting from financial derivative instruments may not exceed 100% of the UCITS's NAV, and therefore that the UCITS's overall risk exposure may not exceed 200% of the NAV on a permanent basis.

Managers are required to select an appropriate methodology to calculate the exposure arising from positions in financial derivative instruments. However, the calculation of the global exposure represents only one element of a fund's overall risk management process.

Funds that use derivatives as a fundamental part of their investment objective, engage in complex investment strategies which represent more than a negligible part of the UCITS's investment policy, or have more than a negligible exposure to exotic derivatives, must use an advanced risk measurement methodology (supported by a stress testing program) such as the Value-at-Risk (VaR) approach to calculate global exposure.

Funds which do not use derivatives as a fundamental part of their investment objective may use the commitment approach, whereby the derivative positions are converted into the equivalent position in the underlying assets embedded in those derivatives.

Limitation of counterparty risk exposure for OTC derivatives

The exposure to any one counterparty in an OTC derivative transaction must not exceed 5% in value of the scheme property. Where the counterparty is an approved bank, this limit is raised to 10%.

UCITS are required to measure the exposure per counterparty on an OTC derivative transaction on the basis of the maximum potential loss incurred by the UCITS if the counterparty defaults, and not on the basis of the notional value of the OTC contract.

A UCITS may net the OTC derivative positions of a UCITS scheme with the same counterparty, provided:

(a) it is able legally to enforce netting agreements with the counterparty on behalf of the UCITS scheme; and

(b) the netting agreements in (a) do not apply to any other exposures the UCITS scheme may have with that same counterparty.

A UCITS may also reduce the exposure of the scheme property to a counterparty to an OTC derivative transaction through the receipt of collateral. Collateral received must be sufficiently liquid so that it can be sold quickly at a price that is close to its pre-sale valuation. In calculating exposure to counterparty risk, the UCITS must take into account collateral that has been passed to the counterparty to an OTC derivative transaction.

Cover

A UCITS must ensure that its global exposure relating to derivatives and forward transactions held in the UCITS scheme does not exceed the net value of the scheme property. Global Exposure must be calculated on a daily basis and must be calculated taking into account the current value of the underlying assets, the counterparty risk, future market movements and the time available to liquidate the positions.

Nature of the underlying financial instrument

Member States are recommended to require that the underlying financial instrument of financial derivative instruments, whether they provide for cash-settlement or physical delivery, as well as the financial instruments held for cover, have to be compliant with the Directive and the individual investment policy of the UCITS.

### j. *How are investors protected against risk from the use of derivatives?*

The FSA requires any Manager who wishes to use derivatives to draw up and comply with a Risk Management Process (RMP). This applies to Managers of UCITS, NURS and QIS.

An RMP must be established to monitor and measure, as frequently as appropriate, the risk of a fund's positions and their contribution to the overall risk profile of the fund. The RMP should take account of the investment objectives and the policy of the fund as stated in the most recent Prospectus. The Manager is expected to demonstrate more sophistication in its process for a fund with a complex risk profile than for one with a simple risk profile.

The Manager must notify the FSA in advance of any derivative transactions being performed about the methods used for estimating risks in derivative and forward transactions and the types of derivatives and forwards to be used within the fund, together with their underlying risks and any quantitative limits. The process should enable this analysis to be undertaken at least daily, or at each valuation point, whichever is the more frequent.

The Depositary is responsible for taking reasonable care to review the appropriateness of the risk management process in line with its duties as set out in the COLL sourcebook.

### k. *Tell me more about the Risk Management Process*

Managers will generally establish a Committee, made up of senior individuals within a firm, and who maintain a significant degree of independence from the portfolio manager, to be responsible for overseeing the Manager's use of derivatives and other financial instruments. The members of the Committee should understand the various instruments used (including derivatives) and should seek additional professional advice and support from external specialists as necessary. This Committee may also be responsible for reporting regularly to the Manager's board on derivative positions and exposures and for examining the qualifications and experience of senior managers to ensure that undue reliance is not placed on too few persons.

The use of derivatives should be monitored and reviewed regularly by persons independent of those involved in managing derivatives and these activities must comply with the FSA rules. Staff responsible for controlling risks and administering transactions should be independent of those initiating the transactions. They are required to have the skills and experience to enable them to challenge the initiators effectively if necessary. As well as ensuring procedures are adequately documented, there should be contingency plans in place to cover staff leaving and links with both internal and external audit processes.

Upon the request of investors in a UCITS, the Manager must provide supplementary information relating to the quantitative limits applying to the risk management of the fund, the methods used in relation to risk management and any recent developments of the risk and yields of the main categories of investment.

### 3.3 The dealing process

#### a. *Is the process of buying or redeeming units regulated?*

Under the FSA rules, the Manager is responsible for arranging for the issue and cancellation of fund units, and is permitted to sell and redeem units for its own account. These rules aim to ensure that the Manager not only treats the fund fairly when arranging for the issue and cancellation of units, including in relation to its own holdings, but also treats investors fairly when their units are purchased or sold. There are common standards for how the amounts in relation to the transaction are to be paid, which include the initial offer of units, the exchange of units for fund assets, and the issue and cancellation of units by an OEIC, or by the Trustee of an AUT, carried out directly with the unitholder. Due to the level of control that the Manager has in issuing, cancelling, selling and redeeming units, it occupies a position that could, without the appropriate systems and controls being in place, involve a conflict of interest between itself and fund investors. As such, Managers are required to take reasonable care to establish and maintain appropriate systems and controls, as are appropriate to its business, to manage any potential conflict of interest between itself and its investors.

#### b. *Tell me more about the process of buying and redeeming units*

There are a number of ways in which an investor may place a deal when buying or redeeming units and this will be dependent on whether the investor is buying directly from the Manager or via an intermediary, such as an independent financial adviser. Managers are required to detail the arrangements for the sale and redemption of units, including settlement terms, in the fund Prospectus.

There is an obligation on the Manager to pay the fund for the creation of units (when an investor has placed a deal) and for the Depositary to pay for the cancellation of units (when an investor has redeemed some units) by close of play on the fourth business day following the instruction to buy or redeem. Therefore, typically, when buying units, investors are only required to provide payment within four business days of the order being placed. However, this will again be dependent on with whom the investor has placed the deal. In certain circumstances, investors may be required to pay by cash or cheque with their order. Under the FSA rules, where the Manager has received all necessary documentation, payment for redemptions is normally made by the end of the fourth business day thereafter. In the case of FAIFs and QIS, the payment period may be longer. Please see paragraph e below.

### **c.** *Are there any rules regarding the frequency of dealing to which a fund must adhere?*

Under the regulations, a fund must have a minimum of two regular valuation points at least two weeks apart per month. A valuation point is the time at which the manager of the fund calculates the price of units in a unit trust, or shares in an OEIC. A fund is required to publish details of its valuation points for the purpose of dealing in the fund Prospectus. Funds that offer limited redemption arrangements may set their valuation points at least every six months. However, such funds are required to value the fund and publish the unit/share price at least once a month. Funds which are qualifying money market funds, or higher volatility funds, must have at least one valuation point every business day.

### *d. Do any funds operate limited issue arrangements?*

If a fund limits the issue of any class of unit, the Prospectus must provide for the circumstances and conditions under which units will be issued. Where this applies, the Manager may not provide for the further issue of units unless, at the time of the issue, it is satisfied on reasonable grounds that the proceeds of that subsequent issue can be invested without compromising the fund's investment objective or materially prejudicing existing unitholders. Within a fund, unit classes may operate different arrangements for the issue of units provided there is no prejudice to the interests of any unitholder.

### *e. Do any funds operate limited redemption arrangements?*

The instrument constituting the scheme and the Prospectus of a NURS that invests substantially in real estate, or whose investment objective is to provide a specified level of return, may provide for limited redemption arrangements appropriate to its aims and objectives. Where this is the case, the fund must provide for redemptions at least once every six months. Within a fund, unit classes may operate different arrangements for redemption of units provided there is no prejudice to the interests of any unitholder.

The rules governing QIS also allow for limited redemptions. The maximum allowable period between dealing days will be dependent on the target investor group, and the investment objectives and policy of the fund. For example, for a scheme that aims to invest in large real estate developments, it would be reasonable for investors to expect a much longer period of time between dealing days for liquidity reasons than for a scheme that invests predominantly in equities.

Fund of Alternative Investment Funds (FAIFs) may set up their redemption arrangements so that 185 days elapse between acceptance of the redemption request and the payment to the investor of the redemption proceeds.

### *f. Do any funds offer deferred redemption arrangements?*

UCITS and NURS that have at least one valuation point per business day are permitted to defer redemptions from one valuation point to the next, provided this information is detailed within the instrument constituting the scheme and the Prospectus. FAIFs and QIS are also permitted to defer redemptions provided this information is detailed within the instrument constituting the scheme and the Prospectus. Managers have the ability to defer redemptions in order to protect the interests of those unit holders who continue to remain invested in the fund by matching the level of sales and redemptions and, at the same time, reducing the impact of dilution on the property of the scheme. Managers are required to ensure that all unit holders who seek to redeem units during a period of deferred redemption are treated equally.

Redemptions may be deferred where the requested redemptions at a particular valuation point have exceeded 10% of the fund's value. However, this percentage could be higher or lower, subject to the percentage being disclosed in the fund's Prospectus.

## 3.4 Pricing and valuation

### **a.** *How are funds priced?*

There are three pricing methods available to the Manager (see below). Under the FSA rules, Managers are permitted to select the most suitable pricing method for a fund, taking into account the needs and expectations of the fund's investors. Whichever method is selected must be recorded in the Prospectus. The regulations require that, once calculated, a price be quoted to at least four significant figures. For example, a figure of 61.3584 pence per unit would be quoted as 61.36 pence per unit. At all stages, the fundamental aim of fund pricing is to ensure that investors deal at a price that truly reflects the value of the fund's property. The official prices must then be published to enable investors and potential investors to assess the performance of each scheme over time. The FSA rules include a requirement to ensure that the prices are made public in an appropriate manner, including the ability for an investor to be able to obtain prices at a reasonable cost and at reasonable times. The place of publication must be disclosed to investors in the Prospectus and must be published in a consistent manner. The Manager is also required to make previous prices available to any investor on request.

**b.** ***What are the three pricing methods available?***

The three pricing methods available to the Manager are dual pricing, single pricing with dilution levy and swinging single pricing.

**c.** ***What is dual pricing?***

Dual pricing is the traditional method used to price funds in the UK. This system uses two pairs of prices: one pair is for issuing and cancelling fund units and the other pair is for selling units to investors and subsequently redeeming their units. The issue price is used to 'create' new fund units and is calculated using the offer prices of the portfolio of investments plus notional dealing costs. Similarly the cancellation price uses the bid prices of the portfolio of investments and notional dealing costs are deducted. Managers can decide to set the selling and redemption prices within certain limits. The selling (or offer) price of a unit cannot be more than the maximum sale price, which is the issue price plus any initial charge. The redemption price (or bid) cannot be less than the cancellation price. Details of the pricing methodology must be provided in the prospectus.

Notional dealing costs cover the transaction charges incurred in creating or cancelling units. These notional dealing costs represent the costs associated with buying and selling the underlying investments that make up the portfolio. In particular, for each relevant market, notional dealing costs include fees and commissions paid to agents, advisers, brokers and dealers, levies by regulatory agencies and securities exchanges, and transfer taxes and duties.

The Manager's initial charge, which covers promotional expenses, commissions to agents and administrative costs, is included only in the offer price at which units are sold to investors. Some Managers levy an exit charge for those investors redeeming units. This will be detailed in the Prospectus. In addition, a Manager may, providing it is stated in the Prospectus, make a charge to provide for Stamp Duty Reserve Tax (SDRT) – see section 4 "What is Stamp Duty Reserve Tax (SDRT)?"

This would require payment of an SDRT provision for the issue or sale of units and deduction for the redemption or cancellation of units.

Managers are required to notify the Depositary of each of the four prices – cancellation, bid, issue and offer. This enables the Depositary to confirm the required number of units to be created or cancelled on any given day and assists them in their oversight responsibilities in ensuring that the Manager's dealing records have been accurately maintained.

### d. *What is single pricing with dilution levy?*

Single pricing is the most simplistic approach to pricing and requires the Manager to calculate one price at each valuation point. This price will be used for both the creation and cancellation of units, and all unit deals with investors take place at this single price. Rather than using bid and offer prices, a single-priced fund will use a single mid-market price (the price mid way between the actual bid and offer prices), based on the average of actual market prices, but does not take into account any dealing costs or spreads. As portfolio transaction charges and spreads are still applicable when using single pricing, a dilution levy may be applied by the fund.

The dilution levy is an adjustment which may be made to an investor's transaction. The Manager will set the criteria for the use of the levy and must ensure that the policy for charging is detailed in the Prospectus. For example, the levy could be applied to all deals over a certain size. The Depositary is responsible for ensuring that the Manager's rates are appropriate to the fund's investments and the actual brokerage charges suffered. On the contract note, the initial charge will be shown as a separate charge for investors purchasing units, as would any exit charge for investors redeeming units, if applicable. Any dilution levy would also be detailed separately as would any SDRT (see section 4 "What is Stamp Duty Reserve Tax (SDRT)?").

Managers are required to notify the Depositary of the final price. This enables the Depositary to confirm the required number of units to be created or cancelled on any given day and assists them in their oversight responsibilities in ensuring that the Manager's dealing records have been accurately maintained.

### e. *What is swinging single pricing?*

Swinging single pricing is also known as single pricing with a dilution adjustment. The dilution adjustment is an adjustment made to the unit price, which includes the actual dealing spread and the notional costs of dealing. The Manager will determine the expected net effect of the dealing activity during the day and establish the approximate cost of the underlying transactions. The quoted single price will then be adjusted (or swung) to reflect the dilution adjustment. For example, if the fund was expanding due to more units being sold to investors than being redeemed, then the price would be the mid- market price, in terms of asset value, plus a dilution adjustment to reflect the cost to the fund of buying new assets. This is termed "swing to offer" and is equivalent to the issue price in a dual pricing system. The reverse would be if the fund was contracting due to more units being redeemed than being sold to investors. This is termed "swing to bid" and is equivalent to the cancellation price.

The Manager will set the criteria for the use of swinging single pricing and must ensure that the policy is detailed in the Prospectus. The Manager is also required to notify the Depositary of the price and the quantum of any dilution adjustment contained therein. This enables the Depositary to confirm the required number of units to be created or cancelled on any given day and assists it in its oversight responsibilities in ensuring that the Manager's dealing records have been accurately maintained.

### f. *Are investors offered any protection during the process of pricing and valuation?*

Under the FSA rules, the Manager is required to exercise due diligence in connection with valuation and pricing, and to show that it has complied with the minimum control requirements set out in the rules. The Manager has a duty to ensure that prices used to value investments are correct and to take action to rectify any incorrect valuations. Depending on the magnitude of any error in valuation, this extends to either reimbursing or compensating any investor or former investor, and to the Manager reimbursing the fund (or receiving compensation) for any benefit incorrectly gained. Any such steps are taken with the agreement of the Depositary.

Under the FSA rules, there is a set of minimum checks that a Depositary must perform to satisfy itself that the Manager's pricing operation is adequately controlled and the risk of incorrect prices is minimised. This includes a thorough review of the Manager's pricing system and controls to assess their reliability and valuations.

## 3.5 Payments and Charges

Under FSA rules, there are a number of requirements which govern the types of payments that may be made out of the scheme property of the fund, as well as the charges that may be imposed on investors when buying or selling units in a fund.

### a. *What payments can be made out of the scheme property of the fund?*

The only payments which may be taken from the property of the fund are those which are incurred in paying the parties who operate or administer the fund or for the investment or safe keeping of the property of the fund. The Manager must ensure that no payments are unfair to any class of unit holder in the fund and the details of all payments must be disclosed in the Prospectus.

A Manager is also required to determine whether a payment is to be made from the income property or capital property of the fund. The Manager must pay due regard to whether the nature of the cost is income or capital related and to the objective of the fund. The Manager is also required to agree the treatment of any payment with the Depositary.

### b. *Can performance fees be charged out of the scheme property of the fund?*

Yes. Under the FSA rules, a performance fee may be paid out of the property of the fund to the Manager or the investment adviser. Managers are required to ensure that any remuneration taken from a fund is not unfair to, or materially prejudicial to, the interests of any investor or potential investor in the fund. The FSA provides additional guidance indicating some of the relevant factors to be considered in determining whether this requirement will be met.

Any performance fee structure must be disclosed in the Prospectus. The disclosures should address the main features of the performance fee and must include examples of its operation in plain language and the maximum that it can amount to.

### c. *What are the charges that may be levied on investors when buying or selling units in a fund?*

Initial Charge

The initial charge, sometimes referred to as the initial service charge, is added to the price of a unit/share when investors first invest in a fund. It covers promotional expenses, commissions to agents, such as independent financial advisers, and the administrative cost of adding new investors in the fund onto the register. The charge is calculated as a percentage of price. In practice, the Manager itself keeps little, if any, of this charge.

Exit Charge

Managers may levy an exit charge, which is payable when an investor chooses to redeem their units/shares in a fund. Few Managers have introduced this charge though, and in those few funds where an exit charge is payable, the charge decreases the longer the units/shares are held. For example, redemptions within the first year may incur a 5% charge, reducing to 4% in the second year, and so on. After 5 years, it may be that no exit charge is payable.

Those Managers who apply an exit charge are less likely to apply an initial charge as well. This potentially enables an investor to avoid both an initial and exit charge should they hold their units/shares in a fund for the longer term.

Annual Management Charge

The Annual Management Charge (AMC) is an annual charge levied by the Manager for the operation and administration of the fund. The AMC will be paid in daily installments from the fund to the Manager, who will pay any amounts owing to the investment manager, fund accountant, fund administrator and distributors of the fund. Charges vary from fund to fund, partly due to the complexity of the investment strategy.

Other costs

In addition, other costs, such as the Depositary fee, for oversight and safekeeping of the property of the fund, as well as the fees of auditors and regulators will usually be charged to the fund.

### d. *How do you know what charges will be incurred?*

All UCITS are now required to produce a key investor information document (KIID) which shows all the charges in a table. Investors must be provided with a copy of the KIID before they invest. Other funds may choose to use the same presentation of charges.

| | |
|---|---|
| The charges shall be presented in a table structured in the following way: One-off charges taken before or after you invest | |
| **Entry charge**<br>**Exit charge** | [ ] %<br>[ ] % |
| This is the maximum that might be taken out of your money [before it is invested] [before the proceeds of your investment are paid out] | |
| Charges taken from the fund over a year | |
| **Ongoing charge** | [ ] % |
| Charges taken from the fund under certain specific conditions | |
| **Performance fee** | [ ] % a year of any returns the fund achieves above the benchmark for these fees, the [insert name of benchmark] |

The ongoing charges figure (OCF) represents the charges taken from the fund over a year and includes:

(a) all payments to:
- the Manager and any directors of the fund
- the Depositary
- custodians and any sub-custodians
- any investment adviser
- any delegates of the above;

(b) all payments to providers of outsourced services to the above, including:

- providers of valuation and fund accounting services
- shareholder service providers;

(c) registration fees, regulatory fees and similar charges;

(d) audit fees;

(e) payments to legal and professional advisers; and

(f) any costs of distributing the UCITS.

The following charges and payments are specifically excluded from the OCF:

- Performance fees
- Portfolio transaction costs, except where paid to parties in (a) or (b) above
- Interest on borrowing
- Payments incurred for the holding of derivatives
- Fees paid directly by investors, such as entry/exit fees
- Soft commissions

Managers should also disclose the relevant OCF in the semi-annual short report to investors.

## 3.6 Share Classes

### a. *Can a fund offer different share classes?*

Under the FSA rules, a number of different classes of shares in the fund can be issued, or in the case of an umbrella fund, in any sub-fund. The classes do not have to be the same for each sub-fund. The rules enable Managers to propose any type of unit/share class, provided it is fair to all holders and can be explained in terms of its nature and operation to prospective investors.

Classes typically differ in terms of the fees and expenses that are paid out of the property of the fund due to the different costs involved in servicing the needs of the investors in the various classes. For example, a retail share class may be sold through a financial adviser, with an initial commission payable; another class may be sold directly to the public, with no commission payable; and a third class may be an institutional share class which has a high minimum investment limit and may be available only to financial institutions.

### b. *What is the difference between an income and accumulation share class?*

An income share class will entitle all holders to receive an income dividend at the end of the relevant accounting period. An accumulation share class does not pay out an income dividend. Instead, the Manager will automatically re-invest any accrued income back into the fund.

For more information about income, please see section 3.7 “Income and dividends”.

### c. *What is a currency class unit?*

A currency class unit is different from other units in that its price, having been calculated initially in the base currency of the fund, will be quoted and normally paid for, in the currency of the designation of the class. Any income distributions will also be paid in the currency of the designation of the class. For example, a fund may have a number of share classes, the majority of which are designated in Sterling (in this example, the base currency) but with, say, one share class designated in Euros. Investors in the Euro share class will hold units priced in Euros and receive any distributions in Euros.

### d. *Are UK funds permitted to launch currency hedged share classes?*

Under the FSA rules, funds are permitted to launch hedged unit classes for authorised funds. Managers can use currency hedging transactions for the purpose of reducing the effect of exchange rate fluctuations between the class unit and either (a) the base currency of the fund or (b) any currency in which all or part of the fund's assets are denominated or valued. The benefit and cost will affect only those investors who have chosen to invest in that particular asset class. The ability for the Manager to hedge can potentially reduce or eliminate a currency risk to investment returns.

There are a number of regulatory and operational issues that a Manager must consider prior to launching a hedged unit class, and it must engage with the Depositary and Auditor. For example, the Manager must discuss and agree the accounting procedures with the Auditor, and the Depositary will need to sign off the Prospectus and agree ongoing reporting for the hedged unit class.

A hedged unit class cannot be created unless it has specifically been provided for in the instrument constituting the scheme. The implications of the hedging policy must also be disclosed in the Prospectus and the Simplified Prospectus.

The Manager is also required to ensure that the appropriate methodology and systems are in place to support the hedged unit class from initial launch through to the ongoing operation of the hedged unit class. A Risk Management Process must also be in place before the Manager launches a hedged unit class.

## 3.7 Income and dividends

### a. *Will I receive any income from my investment?*

Yes. Once any permitted expenses have been deducted, the remaining income for the year must be either paid out to investors in the fund or reinvested on their behalf. Reinvestment will be reflected in the price of the accumulation units/shares or by the purchase of additional units/shares in the case of income units/shares by the Manager. Details about an investor's entitlement to receive income, and the nature of this income, will be disclosed in the Prospectus.

Under the FSA regulations, the Manager and the Depositary are permitted to agree a minimum limit below which a distribution of income is deemed uneconomical, and how such amounts should be treated.

**b.** ***When will I receive this income?***

The FSA regulations state that a fund must have an annual accounting period and that all income arising in that period, after deducting expenses, must be distributed. The Manager may also elect to distribute income for one or more interim periods during the annual period. Details of the annual and interim accounting periods will be contained in the Prospectus.

The Depositary, in conjunction with the Registrar of the fund, is required to distribute any income to investors, or to allocate any income to the accumulation units/shares of the fund as appropriate. The payment of income must be made within four months of the end of the period to which it relates.

**c.** ***What does ex-distribution date (XD date) mean?***

As a fund typically receives income spread throughout the accounting period, the price of the unit/share reflects this income as it accrues, up until the end of the distribution period. The ex-distribution (or "without" distribution) date is the date of the first fund valuation after the end of that period. Therefore, any investors who buy units/shares on or after that date will not be entitled to receive any income (distribution) relating to the distribution period just ended.

As investors purchase and redeem units on a daily basis, the composition of a fund's investor base will change each day. The XD date is necessary to ensure only the investors with an entitlement to the distribution receive a distribution payment from the fund.

**d.** ***What is meant by the term "equalisation"?***

As explained above, a fund typically receives income spread throughout the accounting period and the price of the unit/share reflects this income as it accrues, up until the end of the relevant distribution period. When units/shares are issued (or cancelled), the income element of the issue (or cancellation) is added to (or deducted from) the amount available for distribution. This ensures that the distribution per unit/share is not diluted (or concentrated) by issuing (or cancelling) new units/shares. In other words, the distribution rate is "equalised" and the income element is known as "equalisation".

Equalisation arising from the issue of units/shares is paid as part of the distribution to investors that purchased units/shares during the distribution period as a return of capital. The amount of equalisation paid is usually an average rate over the entire distribution period.

## 3.8 Fund suspensions

### a. *What are the reasons for suspension?*

Market failures/exchange closures

Market failures/exchange closures, can result in an inability to price a significant proportion of assets accurately or to obtain the sale proceeds from a significant sale of scheme fund assets needed to meet unit redemptions. This category captures failures/closures arising from events such as terrorist attacks like the 9/11 attack. Such market/exchange closures are generally short term in nature, although some events may be longer lasting.

Other, independent events

There may be other events, such as natural disasters or catastrophes, which make it impossible to value, or dispose of and obtain payment for, all or some of a fund's assets.

Structural issues

This includes the failure of one of the key parties involved in the operation of the fund and, as a consequence, it is believed that, due to exceptional circumstances, it is in the interest of all unitholders temporarily to suspend dealings. An example might be the failure of a niche Manager that has a particular set of investment management skills in a highly specialist area, and upon which the fund is dependent in order to meet its objectives. If, due to unforeseen circumstances, the Manager ceases to be available and the Depositary is required to find and appoint a replacement, that could take time and, in the interim, the Depositary may consider that it is in the interest of all unitholders to suspend dealings.

Liquidity issues

These may be market-wide or fund-specific. The Manager is responsible for managing the fund so that units/shares can be redeemed on dealing days. As a consequence, a Manager should have in place sound liquidity management arrangements to meet that obligation. Suspension as a result of a lack of liquidity would therefore be a last resort in cases where, despite good liquidity management, the liquidity position of the fund is such that the Manager believes that, in the interests of protecting investors, dealings in fund units should be suspended.

**b.** ***Who makes the decision to suspend a fund?***

A fund should be suspended only in exceptional cases where circumstances so require and provided it is in the best interests of all unitholders within the fund. Before making the decision to suspend, the Manager and/or Depositary should ensure that any alternative courses of action have been considered. If the Manager decides that it is necessary to invoke a suspension, prior agreement should be obtained from the Depositary. The Depositary may also invoke a suspension and in such cases the Manager is obliged to comply with the Depositary's decision without delay. The Manager is required to ensure that any suspension is temporary, of minimal duration and consistent with the provisions of the Prospectus and the instrument constituting the fund. Once the decision has been made to suspend a fund, the Manager is required to notify investors of the suspension and the reason for suspending.

**c.** ***What happens while a fund is suspended?***

Throughout the period of suspension the Manager must ensure that sufficient details are published to keep unitholders informed about the suspension and its likely duration. The Manager has a responsibility to inform any person who requests a sale or redemption of units during the suspension that all dealings have been suspended and that that person has the option either to withdraw their request or to have their request executed at the first available opportunity after the end of the suspension. The Manager may, however, agree to deal in units. In such cases, all deals accepted during, and those outstanding prior to, the suspension will be undertaken at a price calculated at the first valuation point after the resumption of dealing. If the fund operates limited redemption arrangements, and the reason for suspension affected a valuation point, the Manager must declare an additional valuation point as soon as possible after the resumption of dealings

**d.** ***Does a Manager still need to price the fund during periods of suspension?***

As far as is practicable in the light of the context of the suspension, Managers must continue to comply with as much of the FSA rules regarding valuation and pricing as feasible.

**e.** ***When should a fund suspension cease?***

Suspensions should cease as soon as practicable after the exceptional circumstances have ceased. Managers will have considered criteria, the meeting of which will trigger the resumption of dealing.

**f.** ***How often should the suspension be reviewed?***

The suspension should be formally reviewed by the Manager and Depositary at least every 28 days and the FSA should be informed of the results of this review and any change to the information originally submitted to the FSA regarding the decision to suspend the fund.

### g. *What is the role of the FSA*

It is the responsibility of either the Depositary or Manager (depending on who has invoked the suspension) to inform the FSA immediately of its decision to suspend the fund, stating the reason for its action, and to confirm this in writing. Whilst the rules do not require pre-notification, the FSA encourages early engagement with it regarding potential suspension.

The FSA has stated that: *"a suspension can only be considered as an exceptional measure"* and that *"when necessary and justified, a suspension should protect the interests of unit holders overall".* The FSA's view stems from the recognition that the act of suspending a fund may adversely affect existing unit holders, preventing them from being able to access their investments as expected.

The FSA also expects Managers to consider carefully the liquidity profile of both the current and future underlying investments of a fund on an ongoing basis and has stated that *"a suspension which arises as a result of poor liquidity management within a scheme is **not** acceptable".*

Should a fund experience (or be close to experiencing) liquidity stresses, the FSA expects either the Manager or Depositary to engage, as early as practicable, with the Manager's usual FSA contacts.

## SECTION 4 - HOW ARE FUNDS TAXED?

### a. *How are equity funds taxed?*

Whether a fund is an OEIC or AUT, and whether it is a UCITS, NURS or QIS, does not affect its tax position. It is the nature of the fund's assets that are relevant. All funds must distribute all their net income.

The default tax regime in the UK is that funds are subject to corporation tax at 20% on taxable income, net of expenses. Since 1 July 2009 UK funds have not suffered tax on dividends from investments in foreign securities (and were already not subject to tax on UK dividends). So, after expenses, the amount of taxable income is generally zero for funds predominantly invested in equities. Funds must distribute all net income as dividends, which then may be taxed further in the hands of the investors, depending on their tax position. For accumulation units (see section 3.6b "What is the difference between an income and accumulation share class?"), for taxpaying investors, dividends net of tax are reinvested.

There are three alternative regimes, which produce distributions in line with the nature of the assets.

### b. *How are bond funds taxed?*

"Bond Funds" are 60% or more invested in interest-bearing assets (e.g. cash, debt instruments). They are not taxed on the income (net of expenses) that they distribute, which takes the form of interest. If the investors are UK taxpayers, then the fund must withhold 20% on the interest distributions, which it pays over to the UK government "on behalf of" the investor.

### c. *What are PAIFs and how are they taxed?*

Funds invested 60% or more in assets producing property income (whether land, "bricks and mortar" or property securities, such as REITs) can elect to be PAIFs (Property Authorised Investment Funds). Like bond funds, PAIFs do not suffer corporation tax. The PAIF's distributions are "streamed" between rental income, interest and dividends. For UK tax-paying investors, withholding tax applies to the first two streams.

### d. *What are TEFs and how are they taxed?*

The "TEF" (Tax Elected Funds) regime is also elective and ensures that the fund does not pay corporation tax. A TEF can invest in a mixed portfolio of assets but cannot receive any income directly from UK or overseas real estate. It can invest indirectly via PAIFs or REITs but receives income from those instruments net of tax. A TEF makes two types of distribution – a dividend distribution (taxed at the dividend income tax rates in the hands of investors) and a non-dividend distribution (taxed as interest). A TEF must withhold tax at 20% for investors subject to UK tax on the non-dividend distribution.

### e. *How are investments in offshore funds taxed in the fund?*

If the authorised fund invests in offshore "reporting" funds (i.e. funds that report their income to investors), then the fund treats that investment in the same way as any other investment. The income (net of expenses) must be distributed to investors in the authorised fund. If the offshore fund reports income but does not actually distribute any, then the authorised fund may need to liquidate investments in order to distribute reported income to its investors.

If an authorised fund invests up to 20% in non-reporting offshore funds, then it pays corporation tax at 20% on all gains made on disposals of these investments, called Offshore Income Gains. When investors redeem their units in the UK fund, they may, in addition, suffer capital gains tax. If a fund invests 20% or more in non-reporting offshore funds, then it does not suffer tax on Offshore Income Gains. Instead, UK investors who are tax payers are subject to income tax (or corporation tax) on their entire gains on disposal of units in the authorised fund. Investors who are non-tax payers (e.g. they are exempt, or the gain is below their annual threshold), however, they suffer no tax on disposals. If they are UK taxpayers, then, if the fund is predominantly invested in non-reporting funds, the investors will be in the same position as if they had invested directly in the underlying non-reporting funds. The UK government is consulting on the refinement of the regime to facilitate "mixed" funds (i.e. funds that are only partly invested in non-reporting offshore funds).

### f. *What is Stamp Duty Reserve Tax (SDRT)?*

Like any types of investors, authorised funds pay SDRT on acquisitions of UK equities at the rate of 0.5%. They may also pay additional fund-specific SDRT if they invest in UK equities and other "non-exempt" assets. The headline rate of this fund-specific SDRT charge is also 0.5%, but because the actual charge is reduced according to the proportion of exempt assets held in the fund and the proportion of unit redemptions relative to unit purchases, the effective rate is only about 0.05%, and some funds pay no additional SDRT charge at all.

Rather than undertake the complex calculation that the fund-specific SDRT regime involves, provided it is stated in the Prospectus, the Manager may make a charge on investors to provide for SDRT, and, where charged, the Manager will require payment when units/shares are bought and will deduct a payment when units/shares are sold.