

Consultation Paper

CP16/14*

UCITS V Level 2 Regulation, SFTR and consequential changes to the Handbook



May 2016

Contents

	Abbreviations used in this paper	3
1	Overview	5
2	Summary of proposed changes	8

Annexes

1	List of questions	15
2	Cost benefit analysis	16
3	Compatibility statement	18

Appendices

1	Draft Handbook text UCITS V level 2 regulation instrument 2016	
2	Draft Handbook text Investment funds (securities financing transactions) instrument 2016	

We are asking for comments on this Consultation Paper by 19 July 2016.

You can send them to us using the form on our website at:
www.the-fca.org.uk/cp16-14-response-form.

Or in writing to:

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Despite this, we may be asked to disclose a confidential response under the Freedom of Information Act 2000. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by the Information Commissioner and the Information Rights Tribunal.

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Abbreviations used in this paper

AIF	alternative investment fund
AIFM	alternative investment fund manager
AIFMD	Alternative Investment Fund Managers Directive (EU Directive 2011/61/EU)
AIFMD Level 2 Regulation	Alternative Investment Fund Managers Regulation (EU Regulation 694/2015)
CASS	Client Assets sourcebook
COLL	Collective Investment Schemes sourcebook
CP	consultation paper
EU	European Union
FCA	Financial Conduct Authority
FSMA	Financial Services and Markets Act 2000
FUND	Investment Funds sourcebook
NURS	non-UCITS retail scheme
OEIC Regulations	Open-Ended Investment Companies Regulations 2001 (SI 2001/1228) (as amended)
PS	policy statement
QIS	qualified investor scheme
SFTs	securities financing transactions
SFTR	Securities Financing Transactions Regulation (EU Regulation 2015/2365)
SYSC	Senior Management Arrangements, Systems and Controls sourcebook

Treasury	Her Majesty's Treasury
UCITS	undertaking for collective investment in transferable securities
UCITS depositaries	firms acting as trustee or depositary of UCITS
the UCITS Directive	Undertakings for Collective Investment in Transferable Securities Directive (EU Directive 2009/65/EC) as amended by EU Directive 2014/91/EU
UCITS V	Directive amending the UCITS Directive (EU Directive 2014/91/EU)
UCITS V Level 2 Regulation or Level 2 measures	Commission Delegated Regulation (EU) 2016/438 supplementing Directive 2009/65/EC

1. Overview

Introduction

- 1.1** In this consultation paper (CP) we set out our proposals to amend the rules and guidance in the Client Assets sourcebook (CASS) and the Collective Investment Schemes sourcebook (COLL), following the adoption of the Undertakings for Collective Investment in Transferable Securities V Level 2 Regulation (UCITS V Level 2 Regulation). We are also consulting on minor changes to SYSC and consequential amendments in COLL and the Investment Funds sourcebook (FUND) to reflect certain measures in the Securities Financing Transactions Regulation (SFTR).¹

Who does this consultation affect?

- 1.2** This paper will be of interest to depositaries and trustees of UCITS (UCITS depositaries), management companies of UCITS or other authorised funds, representative trade bodies, auditors, consultants and other advisers in the UK's fund management industry. It will also interest UCITS management companies and full-scope alternative investment fund managers (AIFMs) whose business activities include securities financing transactions (SFTs)² and total return swaps.³

Is this of interest to consumers?

- 1.3** The amendments proposed in this CP are primarily about the requirements for depositaries of UCITS and other authorised funds. They are unlikely to be of direct interest to retail or professional investors. Consumers should not see any change to the normal operation of their investment business. However, we welcome any feedback from consumers and their representatives.

Context

- 1.4** UCITS are regulated open-ended investment funds that can be sold to retail consumers throughout the European Union (EU). The UCITS Directive sets out a harmonised regime for UCITS, their management companies and depositaries, with the aim of achieving a common standard of investor protection across the EU.

¹ Regulation (EU) 2015/2365 of the European Parliament and of the Council of 25 November 2015 on transparency of securities financing transactions and of reuse and amending Regulation (EU) No 648/2012.

² Article 3(11) of the SFTR defines securities financing transactions as: a repurchase transaction, securities or commodities lending and securities or commodities borrowing, a buy-sell back transaction or sell-buy-back transaction, and a margin lending transaction.

³ Article 3(18) of the SFTR defines total return swap as a derivative contract as defined in point (7) of Article 2 of Regulation (EU) No 648/2012 in which one counterparty transfers the total economic performance, including income from interest and fees, gains and losses from price movements, and credit losses, of a reference obligation to another counterparty.

- 1.5** The UCITS V legislative package includes a 'Level 1 Directive', which amends the existing UCITS Directive, and a 'Level 2 Regulation', which sets out additional, detailed requirements for UCITS management companies and depositaries. The Level 1 Directive was transposed into national law on 18 March 2016. The Level 1 Directive was designed primarily to increase investor protection and improve investor confidence in UCITS, by enhancing the rules on the depositaries' responsibilities and introducing remuneration policy requirements for management companies.⁴
- 1.6** In CP15/27⁵ we consulted on amending rules and guidance to transpose the changes from the Level 1 Directive. We implemented these requirements in PS16/2⁶, which set out the Handbook changes affecting managers and depositaries of UCITS and alternative investment funds (AIFs). These amendments took effect on 18 March 2016.
- 1.7** The UCITS V Level 2 Regulation was published by the European Commission on 24 March 2016. It will apply to firms from 13 October 2016. This regulation introduces new requirements for UCITS depositaries. These requirements include safekeeping requirements for UCITS depositaries, requirements for the UCITS management company and the depositary to act independently, and steps to protect the UCITS assets if a third-party delegated custodian becomes insolvent.
- 1.8** The UCITS V Level 2 Regulation is directly applicable to firms and does not require transposition by Member States. However, this CP proposes amendments to certain FCA rules and guidance to ensure consistency with the Level 2 measures. Our proposals are designed to help firms comply with the UCITS V Level 2 Regulation by removing some overlapping requirements between our Handbook and the Level 2 measures. However, to maintain the level of protection provided by the current Handbook provisions for investors in UCITS, we propose to retain existing standards that do not duplicate or conflict with the Level 2 measures.
- 1.9** The SFTR is a separate EU Regulation that came into force on 12 January 2016. The SFTR is directly applicable to firms and does not require transposition by Member States. The SFTR introduces a number of measures including new requirements on the transparency of SFTs, total return swaps and the re-use of financial instruments received under a collateral arrangement. Of relevance to this consultation are the SFTR requirements for managers of UCITS and AIFs to disclose their use of SFTs and total return swaps in the funds' pre-contractual documents and periodic reports to investors. These requirements supplement existing disclosure requirements in COLL and FUND. In this CP we propose to copy out the relevant SFTR provisions into COLL and FUND to help firms comply with the new disclosure requirements. The SFTR contains other provisions which are directly applicable for managers of UCITS and AIFs but these are not considered in this CP.
- 1.10** The requirement to disclose SFT information in the fund's periodic reports to investors will apply from 13 January 2017.⁷ The requirement to disclose SFT information in the funds' pre-contractual documents will apply from 13 July 2017 to managers of funds constituted before 12 January 2016, while managers of new funds constituted since 12 January 2016 should comply with the requirements from the point when the fund has been constituted.⁸

4 UCITS V also introduced a common minimum set of powers available to EU regulators to investigate and sanction breaches of the UCITS Directive. CP15/27: UCITS V implementation and other changes to the Handbook affecting investment funds: <https://www.fca.org.uk/news/cp15-27-ucits-v-implementation-and-handbook-changes>

5 CP15/27: UCITS V implementation and other changes to the Handbook affecting investment funds: <https://www.fca.org.uk/news/cp15-27-ucits-v-implementation-and-handbook-changes>

6 PS16/2: Implementation of the UCITS V Directive: <https://www.fca.org.uk/news/ps16-02-implementation-of-the-ucits-v-directive>

7 Article 33 (2) (b) of the SFTR.

8 Article 33 (2) (c) of the SFTR.

Summary of our proposals

- 1.11** The UCITS V Level 2 Regulation will apply to firms on 13 October 2016. Affected firms should familiarise themselves with the Level 2 measures and ensure they comply with the new requirements by 13 October 2016.
- 1.12** In this CP, we propose consequential amendments to CASS which apply to UCITS depositaries. The majority of changes will be concentrated in CASS 6.6. We propose to disapply certain CASS rules and guidance to ensure consistency with the requirements under the UCITS V Level 2 Regulation.
- 1.13** We are proposing guidance in COLL 6.9 to signpost the conditions for meeting the independence requirements introduced by the UCITS V Level 2 Regulation. Firms should read the new UCITS V Level 2 Regulation requirements in conjunction with our existing guidance on independence in COLL 6.9, which is unchanged.
- 1.14** We are also consulting on a minor amendment to SYSC 19E.2.9R(1), which sets out the circumstances where a UCITS management company must appoint a remuneration committee. This will better align the wording of the SYSC rule with Article 14b(4) of the UCITS Directive.
- 1.15** Separately, we are also consulting on copying out into COLL the SFTR provisions which require managers of UCITS and AIFs to disclose details of their use of SFTs and total return swaps in the funds' pre-contractual documents and periodical reports to investors. This proposal requires changes to COLL 4.2 and COLL 4.5 for UCITS schemes and non-UCITS retail schemes (NURS). We also propose to include specific guidance for qualified investors schemes (QIS) in COLL 8.3 and for full-scope UK AIFMs in FUND 3.2 and FUND 3.3 cross-referring to the COLL 4.2 and COLL 4.5 provisions mentioned above.

Equality and diversity considerations

- 1.16** Under the Equality Act 2010, we are required to have due regard to the need to eliminate discrimination and to promote equality of opportunity in carrying out our policies, services and functions. As part of this, we have assessed the likely equality and diversity impacts and rationale of these proposals and concluded they do not give rise to any concerns for particular groups as a result of any protected characteristic. However, we welcome any comments.

Next steps

What do you need to do next?

- 1.17** Please send us your responses by **Tuesday 19 July 2016**. This consultation period of two months is necessary to allow us to finalise our rules and guidance before the UCITS V Level 2 Regulation takes effect on 13 October 2016.

How?

- 1.18** Use the online response form on our website or write to us at the address on page 2.

What will we do?

- 1.19** We will consider your feedback with the intention of publishing our Policy Statement (PS) in Q3 2016.

2. Summary of proposed changes

Proposed changes to the Handbook resulting from the UCITS V Level 2 Regulation

- 2.1** This section sets out our proposals to amend rules and guidance in the Handbook to give effect to the UCITS V Level 2 Regulation. It also explains our thinking on other matters relating to depositary independence.
- 2.2** Broadly, the UCITS V Level 2 Regulation introduces the following requirements:
- minimum terms in the contract between the management company and the depositary
 - detailed oversight, cash monitoring and safekeeping requirements for the depositary
 - types of assets that the depositary must hold in custody and segregate from the depositary's own assets
 - conditions for the depositary's liability for any loss of assets
 - insolvency protection for assets when delegating safekeeping, and
 - requirements for independence between the management company and the depositary
- 2.3** COLL 6.6 sets out the duties and powers of management companies and depositaries. COLL 6.6B gives details of the rules for implementing the UCITS Directive requirements on depositaries and sets out the operating duties and responsibilities of UCITS depositaries. CASS 6 includes other domestic requirements which apply to UCITS depositaries when they hold clients' safe custody assets.

Proposed changes to CASS

- 2.4** The custody rules (CASS 6) apply to a firm acting as a UCITS depositary. CASS 6 is designed primarily to restrict the commingling of client assets and the firm's assets. The rules minimise the risk of the client's safe custody assets being used by the firm without the client's agreement or contrary to the client's instructions, or being treated as the firm's own assets in the event of its insolvency.

- 2.5** CASS 6 sets out different specialist regimes for trustees and depositaries, including a specialist regime for when a firm is acting as a UCITS depositary.⁹ A separate regime applies to depositaries of AIFs¹⁰ and to trustees and depositaries of funds other than an AIF or UCITS.¹¹
- 2.6** In PS16/2, we set out a new specialist regime for UCITS depositaries. This ensured that a number of rules in CASS 6.6 (Records, accounts and reconciliations) continued to apply, in the absence of the UCITS V Level 2 Regulation being finalised. We have now reviewed the CASS provisions in light of the final Level 2 Regulation and propose amendments to the regime in CASS 6.1.16IDR.
- 2.7** Broadly, the areas where the UCITS V Level 2 Regulation affects CASS include:
- adequate organisational arrangements: depositaries must have adequate organisation arrangements to minimise the risk of loss of assets as a result of fraud, poor administration, inadequate registering or negligence
 - records and accounts: firms must maintain records and segregated accounts in a way that ensures accuracy, and in particular record the correspondence with UCITS assets
 - reconciliation of records: the Level 2 measures imposes strict requirements on depositaries when conducting reconciliations of records
- 2.8** We propose to disapply certain CASS rules and guidance that conflict with, or duplicate the Level 2 measures. The Level 2 measures are broadly in line with the AIFMD Level 2 Regulation¹², so the approach proposed in this CP is similar to the one we took to implement the AIFMD, with minor differences as required.
- 2.9** Where the existing CASS rules are either outside the scope of, or are consistent with, the UCITS V Level 2 Regulation and Level 1 Directive, we propose these rules should continue to apply to UCITS depositaries. This means that, as outlined in PS16/2, the following Handbook chapters will broadly continue to apply:
- CASS 1A and SUP 10.7 (CASS firm classification and operational oversight)
 - CASS 3 (collateral)
 - CASS 8 (mandates)
 - CASS 9 (prime brokerage)
 - CASS 10 (CASS resolution pack)
 - SUP 16.14 (client money and asset return (CMAR)), and
 - SUP 3.10 and SUP 3.11 (annual CASS audit)

⁹ CASS 6.1.16IDR

¹⁰ CASS 6.1.16IAR

¹¹ CASS 6.1.16FR

¹² Commission Delegated Regulation (EU) No 694/2014 of 17 December 2013 supplementing Directive 2011/61/EU of the European Parliament and of the Council with regard to regulatory technical standards determining types of alternative investment fund managers.

- 2.10** This will ensure we maintain an appropriate level of consumer protection. We consider that requirements under the UCITS V Level 2 Regulation and Level 1 Directive are equivalent to the CASS 6 requirements that we are proposing to disapply, or that we have already disapplied through PS16/2 for UCITS depositaries.
- 2.11** Our proposed changes to CASS are similar to the changes we made for depositaries of AIFs when we implemented the AIFMD. The proposed CASS 6 regime for UCITS depositaries will closely align with the CASS 6 regime for AIF depositaries. Minor differences will remain between the CASS rules which apply to UCITS depositaries and AIF depositaries.
- 2.12** Some respondents to CP15/27 asked us to allow a firm acting a UCITS depositary to use the records and accounts of its appointed custodian to meet its CASS record keeping obligations. In PS16/2 we set out that we would consider this when the UCITS V Level 2 Regulation was finalised.
- 2.13** In response to this feedback, when a UCITS depositary delegates its functions in relation to the custody of UCITS assets to a third party delegate, we consider that the depositary can meet its record keeping obligations under CASS 6.6.2R and CASS 6.6.4R if the delegate keeps such records and accounts on their behalf. The UCITS depositary need not maintain a duplicate set of custody records of the relevant assets in order to comply with CASS 6. This is the same as that for AIF depositaries that delegate their functions in relation to the custody of the AIF assets to a third party delegate.
- 2.14** However, the depositary is still responsible for complying with CASS even when it has delegated custody functions. If a delegate keeps these records and accounts on the depositary's behalf, the depositary must ensure it has the appropriate rights to access and verify these records without delay. The depositary is also responsible for ensuring that the delegate maintains those records in a way that ensures their accuracy, and ensures appropriate oversight over the delegate's actions.

Q1: Do you agree with the proposed application of CASS and CASS-related Handbook provisions in relation to depositaries of UCITS? If not, please provide reasons.

Depositary independence

- 2.15** Article 25 of the UCITS Directive requires the management company and the depositary to "act independently". Articles 20 to 24 of the UCITS V Level 2 Regulation set out conditions that management companies and depositaries need to meet to fulfil the independence requirement. These, in summary, include:
- provisions on common management (Article 21)

- an obligation for the management company to have in place a decision-making process, based on objective pre-defined criteria, for the appointment of the depositary and additional obligations which apply when there is a link or a group link, as defined in the UCITS V Level 2 Regulation,¹³ between the management company and the depositary (Article 22)
- conflicts of interest requirements when there is a link or a group link between the management company and the depositary (Article 23), and
- requirements concerning the independence of the management board which apply when there is a group link between the management company and the depositary (Article 24).

2.16 Existing requirements in UK law set the standard for independence between UCITS depositaries and management companies. The Financial Services and Markets Act 2000 (FSMA) and the UK Open-Ended Investment Companies (OEIC) Regulations require the two entities to be independent of each other.¹⁴ Guidance in COLL 6.9.2G to COLL 6.9.5G gives our view of the meaning of independence and identifies certain possible links which we have regard to in determining whether independence exists.¹⁵ In practice, these requirements have led to a situation where UK depositaries and management companies are structurally independent, i.e. they do not belong to the same group. These requirements have for many years delivered a high level of investor protection by minimising the risk that the depositary will face a conflict of interest between the performance of its duties and its involvement, directly or through associates,¹⁶ in a wider range of activities where the fund manager also has a commercial interest. Structural independence allows the depositary to carry out a broad function of oversight, delivering an appropriate degree of independent governance for the fund on behalf of its unitholders.

2.17 In light of the above, and taking account of the fact that the Government's Statutory Instrument implementing UCITS V¹⁷ has not amended the independence provisions in FSMA and the OEIC Regulations, we propose to retain the existing guidance in COLL 6.9 which relates to those provisions. This will result in stricter independence standards than those required under the UCITS Directive that we consider are justified by the increased investor protection benefits. In addition, we have taken into account Recital 30 of the UCITS V Level 2 Regulation which recognises that individual Member States might not permit interconnections between the UCITS management company and the depositary such as those arising from common management or cross-shareholdings.

¹³ Article 1 of the UCITS V Level 2 Regulation provides a definition of "link" and "group link": "For the purpose of this Regulation, the following definitions shall apply:

(a) 'link' means a situation in which two and more natural or legal persons are either linked by a direct or indirect holding in an undertaking which represents 10 % or more of the capital or of the voting rights or which makes it possible to exercise a significant influence over the management of the undertaking in which that holding subsists;

(b) 'group link' means a situation in which two or more undertakings or entities belong to the same group within the meaning of Article 2(11) of Directive 2013/34/EU of the European Parliament and of the Council or international accounting standards adopted in accordance with Regulation (EC) No 1606/2002 of the European Parliament and of the Council ."

¹⁴ See section 243 (4) of FSMA for authorised unit trusts, section 261D (4) of FSMA for authorised contractual schemes and Regulation 15 (8) (f) of the OEIC Regulations for open-ended investment companies.

¹⁵ COLL 6.9.2G to COLL 6.9.5G set out the types of links between the management company and the depositary and the circumstances that the FCA would take into account when assessing whether the two entities are independent. In particular the FCA guidance identifies three links that might affect independence: influence by directors (COLL 6.9.3G), influence by shareholding (COLL 6.9.4G) and contractual commitments (COLL 6.9.5G).

¹⁶ See the Glossary definition of "associates" in the FCA Handbook.

¹⁷ S.I. 2016/225.

- 2.18** We have considered the alternative option of removing the existing COLL 6.9 guidance on this subject and relying solely on the UCITS V Level 2 Regulation independence requirements. However, we have not pursued this option as we consider its effect would be to reduce the current standards of investor protection in the UK.
- 2.19** As a result, some of the Level 2 measures are unlikely to apply to UK management companies and depositaries in practice because, in accordance with the existing independence standards, they would not be in the same group. In particular:
- the requirements concerning the independence of management boards would only apply to management companies and depositaries where a group link exists between them (Article 24)
 - the additional requirements for the appointment of the depositary (Article 22 (2)) and conflicts of interest provisions (Article 23) may be relevant to UK management companies and depositaries when a link exists as defined in the UCITS V Level 2 Regulation. For example, according to Article 1 of the UCITS V Level 2 Regulation, such a link would exist when the two entities are linked by a direct or indirect holding in an undertaking which represents 10% of the capital or of the voting rights. However, according to COLL 6.9.4G independence is considered likely to be lost only if there is a cross-shareholding above 15%. So when there is a cross-shareholding between the management company and the depositary falling between the 10% and 15% thresholds, it is possible that Article 22 (2) and Article 23 would apply
- 2.20** However, the requirements regarding common management (Article 21), the decision-making process for appointing the depositary (Article 22(1) and (3)), and the delegation of safekeeping (Article 22(5)), would still be relevant for all management companies and depositaries.
- 2.21** As a result, we are consulting on additional guidance in COLL 6.9 to signpost firms to the relevant Level 2 requirements on independence that need to be read alongside our existing guidance on independence.

Q2: Do you agree that retaining the existing guidance in COLL 6.9, when read together with the UCITS V Level 2 Regulation, will not result in a reduction in the current level of investor protection?

Minor changes to SYSC 19E.2.9R

- 2.22** Article 14b(4) of the UCITS Directive requires a management company to establish a remuneration committee if the firm is significant in terms of its size or the size of the UCITS it manages, its internal organisation and the nature, scope and complexity of its activities. This requirement is transposed in SYSC 19E.2.9R(1) as follows:
- “A management company must establish a remuneration committee if it is significant in terms of:
- a. its size; or
 - b. the size of the UCITS that it manages; or
 - c. the complexity of its internal organisation; or
 - d. the nature, the scope and the complexity of its activities.”

2.23 The use of the conjunction “or” (instead of “and”) in SYSC 19E.2.9R(1) between conditions (b),(c), and (d) in the Handbook provision above suggests a need for a remuneration committee if any one of the conditions in (a) to (d) is satisfied. This has generated some questions from stakeholders and we propose aligning the wording in SYSC 19E.2.9R(1) with the wording of Article 14b(4). This clarifies that a management company will be required to establish a remuneration committee only if it is significant in terms of all three relevant criteria listed above:

- Its own size or the size of the UCITS it manages
- the complexity of its internal organisation, and
- the nature, scope and complexity of its activities

Q3: Do you agree with our proposed changes to SYSC 19E.2.9R(1)? If not, please provide reasons.

Proposed changes to the Handbook resulting from the SFTR

2.24 The SFTR introduces a number of measures including new requirements on the transparency of SFTs, total return swaps and re-use of financial instruments received under a collateral arrangement. Among these, the SFTR sets out new disclosure requirements for managers of UCITS and AIFs.

2.25 Article 13 of the SFTR requires UCITS management companies and AIFMs authorised under the AIFMD¹⁸ to inform investors, in the annual and half-yearly reports for UCITS and in the annual report for AIFs, about the use they make of SFTs and total return swaps. Section A of the Annex to the SFTR specifies the disclosures to be included in the reports. COLL 4.5, COLL 8.3 and FUND 3.3 set out the existing disclosures to be included in the periodic reports for UCITS and AIFs. In order to help firms comply with the disclosure requirements, we are proposing to copy out the additional SFTR disclosure requirements at Article 13(1) and (2) and Section A of the Annex of the SFTR as an EU provision alongside the existing disclosure provisions applicable to UCITS and NURS in COLL 4.5.¹⁹ We are also proposing to introduce guidance on these provisions.²⁰ To avoid unnecessary duplications we have introduced cross-references in COLL 8.3 and FUND 3.3,²¹ for QIS and AIFMs respectively, to the proposed copied out EU provisions at COLL 4.5.8ACEU and 4.5.8ADEU.

2.26 Similarly, Article 14 of the SFTR requires UCITS management companies and AIFMs authorised under the AIFMD to specify in their pre-contractual documents the SFTs and total return swaps they are authorised to use and to include a clear statement that those transactions and instruments are used. Section B of the Annex to the SFTR specifies the disclosures to be included in the pre-contractual documents. Existing rules set out the disclosures to be included in the prospectus of a UCITS, a NURS and a QIS (COLL 4.2 and 8.3) and by an AIFM in the pre-contractual documents of an AIF (FUND 3.2), respectively. In order to help firms comply with the SFTR we are proposing to copy-out the additional SFTR disclosure requirements at Article 14(1) and (2) and Section B of the Annex of the SFTR as an EU provision alongside the existing COLL 4.2 requirements.²² We are also proposing to introduce guidance explaining

¹⁸ In the UK these are referred to as “full-scope UK AIFMs”.

¹⁹ See proposed COLL 4.5.8ACEU and 4.5.8ADEU.

²⁰ See proposed COLL 4.5.8ABG.

²¹ See proposed COLL 8.3.5ABG and FUND 3.3.7BG.

²² See proposed COLL 4.2.5BEU and COLL 4.2.5CEU.

these provisions.²³ Again, to avoid unnecessary duplications, we also propose to introduce cross-references to the proposed copied out EU provisions at COLL 4.2.5BEU and 4.2.5CEU for QIS and AIFMs in COLL 8.3 and FUND 3.2, respectively.²⁴

- 2.27** Since managers of NURS and QIS must issue a prospectus under COLL 4.2 or COLL 8.3, our proposed guidance will clarify that these managers should disclose the SFTR information in the prospectus instead of disclosing it in other pre-contractual documents. We do not expect this proposal to have additional cost implications for firms, but investors and managers will both benefit from having the SFTR disclosure alongside the other relevant information about the fund and the fund manager in the prospectus.
- 2.28** In our proposed guidance we also clarify that firms which are not using, or which are not authorised to use, SFTs or total return swaps are not required to make any disclosures under Articles 13 and 14 of the SFTR.
- 2.29** The periodic reports requirements in Article 13 will apply to firms from 13 January 2017.²⁵ and our proposed provisions relating to these requirements²⁶ will not come into force until this date. With regard to the pre-contractual disclosure requirements in Article 14, the SFTR allows managers a transitional period, until 13 July 2017, for funds constituted before 12 January 2016.²⁷ We propose to have transitional provisions for our guidance, aligned with the transitional in the SFTR. These also set out our view that sub-funds constituted after 12 January 2016, even if the umbrella scheme of which they are part was constituted before that date, would not benefit from the transitional measure in the SFTR.²⁸ We note that the European Commission may issue a clarification on this and other points concerning the SFTR. We will take any further communication from the European Commission into account when finalising our Handbook provisions in due course.
- 2.30** As mentioned in paragraph 1.9 above, the SFTR is directly applicable to firms. Firms should ensure that they comply with any obligations under the SFTR which go beyond our Handbook. For example, Article 4 of the SFTR sets out reporting obligations for counterparties to SFTs and clarifies that, where a UCITS or an AIF is the counterparty to SFTs, the management company or the AIFM is responsible for the reporting. Similarly, Article 15 of the SFTR sets out requirements on the re-use of financial instruments received under a collateral arrangement and firms should note that it goes further than our provisions in CASS 6.4 on re-use of assets.

Q4: Do you agree with our proposed amendments to the Handbook resulting from the SFTR? If not, please provide reasons.

Q5: Are there any other points we should address in the Handbook in relation to the SFTR?

²³ See proposed COLL 4.2.5AG.

²⁴ See proposed COLL 8.3.2AG and FUND 3.2.4AG.

²⁵ Article 33 (2) (b) of the SFTR.

²⁶ COLL 4.5.8ABG, COLL 4.5.8ACEU, COLL 4.5.8ADEU, COLL 8.3.5ABG and FUND 3.3.7BG.

²⁷ Article 33 (2) (c) of the SFTR.

²⁸ See proposed COLL TP1.1(38) and (39) and FUND TP1(7).

Annex 1

List of questions

- Q1:** Do you agree with the proposed application of CASS and CASS-related Handbook provisions in relation to depositaries of UCITS? If not, please provide reasons.
- Q2:** Do you agree that retaining the existing guidance in COLL 6.9, when read together with the UCITS V Level 2 Regulation, will not result in a reduction in the current level of investor protection?
- Q3:** Do you agree with our proposed changes to SYSC 19E.2.9R(1)? If not, please provide reasons.
- Q4:** Do you agree with our proposed amendments to the Handbook resulting from the SFTR? If not, please provide reasons.
- Q5:** Are there any other points we should address in the Handbook in relation to the SFTR?

Annex 2

Cost benefit analysis

1. FSMA requires us to publish a cost benefit analysis (CBA) when proposing draft rules. Specifically, section 138I requires us to publish a CBA of proposed rules, defined as ‘an analysis of the costs, together with an analysis of the benefits that will arise if the proposed rules are made’. It also requires us to include an estimate of those costs and benefits, unless these cannot reasonably be estimated or it is not reasonably practicable to produce an estimate.
2. As the UCITS V Level 2 Regulation is directly applicable to firms, we have little discretion to make changes other than to ensure consistency of our rules and guidance with the Level 2 measures. We have therefore undertaken only a high-level CBA as we consider it would be disproportionate, and hence ‘not reasonably practicable’, to spend a significant amount of resources on estimating the costs and benefits associated with these changes.
3. Our proposed approach ensures the continuation of the current standard of consumer protection. The proposed changes to CASS are similar to the approach taken for depositaries of AIFs when we implemented the AIFMD. Our permissions data indicates that almost all regulated UCITS depositaries in the UK also have the regulatory permission to act as a depositary or trustee of an AIF. This suggests that UCITS depositaries should already largely have the necessary systems in place to comply with our changes to the specialist regime in CASS 6 for UCITS depositaries.
4. Overall, the proposed changes to CASS reduce the regulatory burden under CASS on UCITS depositaries, compared to the current regime of CASS 6 provisions applicable to UCITS depositaries. We expect firms may incur some one-off costs to amend relevant processes and policies and any increased one-off costs resulting from the Level 2 Regulation will be of minimal significance.
5. We propose to retain those CASS 6 provisions that are either outside the scope of, or are consistent with, the Level 2 measures. We consider the Level 2 measures to be equivalent to the CASS 6 requirements that we propose to disapply in this CP. Therefore, we believe that the level of consumer protection will be maintained by the Level 2 measures when they take effect.
6. The retention of the existing guidance on independence in COLL 6.9.2G to COLL 6.9.5G would not result in additional compliance costs for firms as they should already be compliant with the current standards. Only those management companies which are part of a depositary group will be affected by the retention of the existing guidance. We estimate UCITS management companies which are in the same group as a depositary account for circa 10% of total funds under management in the UK.¹ UCITS management companies with depositaries in the same group also represent less than 10% of the total number of UK UCITS management companies.

¹ Our estimates are based on the monthly company rankings by funds under management as of December 2015 available on the Investment Association’s website:
www.theinvestmentassociation.org/investment-industry-information/fund-statistics/monthly-company-rankings.html

7. The key benefit deriving from the current UK standards is the high level of investor protection resulting from the structural independence of the depositary. This allows the depositary to perform effective independent oversight of the activities of the management company. The current standards also limit the possibility of potential conflicts of interest arising between the two entities. This, in turn, reduces the risk that the depositary might put the interests of its own group ahead of those of the UCITS and the investors in the UCITS. As a consequence, the existing standards of independence provide better assurance to investors in UCITS that the assets of the fund are kept safe and the activities of the authorised fund manager are effectively overseen, resulting in a greater level of confidence in the UK UCITS market.
8. We expect that there might be some opportunity costs in cases where the management company would not, because of the existing COLL 6.9 guidance, appoint a depositary within its own group even though that depositary could offer a lower price than its competitors. The appointment of a depositary within the same group as the management company could also result in some further savings deriving from operational efficiencies within the group. It is difficult to estimate what those savings (if any) could be.
9. Nevertheless, any such potential savings would be, at least partially, offset by the costs resulting from the additional independence requirements that otherwise would be applicable under the UCITS V Level 2 Regulation to management companies and depositaries within the same group. For example, both the management company and the depositary would in these circumstances have to appoint a minimum number of independent directors (two persons or one third of the members of the board, whichever is lower).² This requirement would result in additional costs for the industry that we estimate to be between £600,000 and £1,440,000 per year.³ Further costs will also result from the additional conflicts of interest requirements⁴ and the requirements around the process for appointing a depositary within the group of the management company.⁵
10. The current wording in SYSC 19E.2.9R(1) might inadvertently make UCITS management companies that do not meet the criteria in Article 14b(4) of the UCITS Directive subject to the requirement to have a remuneration committee. The proposed change to SYSC 19E.2.9R(1) is intended to align the rule with the relevant provision in the UCITS Directive and, as a consequence, with the CBA in CP15/27.
11. We have not carried out an additional CBA for the proposed changes in relation to the SFTR, as we are simply introducing some of its provisions into the Handbook by way of copy-out. With regard to the proposal for authorised AIFs to comply with the pre-contractual disclosure requirements by disclosing the relevant SFTR information in the prospectus, we expect it to have minimal cost implications for firms. This is because there is already an appropriate transitional provision in the SFTR allowing firms to update, by 13 July 2017, the relevant pre-contractual documents of funds constituted before 12 January 2016 and which are subject to the SFTR (Article 33(2)(c)).

² Article 24 of the UCITS V Level 2 Regulation.

³ There are 10 UCITS depositaries in the UK. Assuming each one has at least a management company within its group, this would make 20 firms that might be subject to the UCITS V Level 2 Regulation independence requirements. Some of these firms would already have a sufficient number of independent directors to meet these requirements, so we estimate the firms affected to be between 5 and 12. As a consequence, we estimate the following costs:

- 5 firms x an average of 2 directors per firm x £60,000 (based on four meetings per year with 40 hours preparation and attendance at an hourly rate of £365 gives us 4 x 40 x £365 = £60,000 approximately) = £600,000 per annum
- 12 firms x an average of 2 directors per firm x £60,000 (based on four meetings per year with 40 hours preparation and attendance at an hourly rate of £365 gives us 4 x 40 x £365 = £60,000 approximately) = £1,440,000 per annum
- Additional one-off costs would be borne by firms for the recruiting of independent directors (for example time and resources spent in the recruitment process and head hunters' fees). These costs would vary depending on the specific circumstances of each firm

The estimated rates for independent directors' remuneration above are based on the CBA conducted in the Financial Services Authority's CP 11/5 "Protecting with-profits policyholders".

⁴ Article 23 of the UCITS V Level 2 Regulation.

⁵ Article 22 (2) of the UCITS V Level 2 Regulation.

Annex 3

Compatibility statement

Compatibility with the FCA's general duties

1. Section 138I(2)(d) of FSMA requires us to explain why we believe our proposed rules are compatible with our strategic objective, advance one or more of our operational objectives, and have regard to the regulatory principles in section 3B of FSMA. In addition, section 138K(2) of FSMA requires us to state whether the proposed rules will have a significantly different impact on mutual societies as opposed to other authorised persons.
2. The proposals in this CP are intended to advance our operational objective of securing appropriate levels of consumer protection by ensuring that our rules are consistent with the provisions in the UCITS V Level 2 Regulation and the SFTR.
3. In preparing the proposals in this chapter, we have had regard to the regulatory principles set out in section 3B of FSMA and the importance of taking action intended to minimise financial crime as part of section 1B(5)(b) of FSMA.
4. We do not believe that the changes described in this chapter will have a different impact on mutual societies compared to other authorised persons.

Appendix 1

Draft Handbook text

UCITS V level 2 regulation instrument 2016

UCITS V LEVEL 2 REGULATION INSTRUMENT 2016

Powers exercised

- A. The Financial Conduct Authority makes this instrument in the exercise of the following powers and related provisions in or under:
- (1) the following sections of the Financial Services and Markets Act 2000 (“the Act”):
 - (a) section 137A (The FCA’s general rules);
 - (b) section 137H (General rules about remuneration);
 - (c) section 137T (General supplementary powers);
 - (d) section 139A (Power of the FCA to give guidance);
 - (e) section 247 (Trust scheme rules);
 - (f) section 248 (Scheme particular rules);
 - (g) section 261I (Contractual scheme rules); and
 - (h) section 261J (Contractual scheme particular rules); and
 - (2) regulation 6(1) of the Open-Ended Investment Companies Regulations 2001 (SI 2001/1228).
- B. The rule-making powers listed above are specified for the purpose of section 138G(2) (Rule-making instruments) of the Act.

Commencement

- C. This instrument comes into force on *[date]* 2016.

Amendments to the Handbook

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

(1)	(2)
Glossary of definitions	Annex A
Senior Management Arrangements, Systems and Controls sourcebook (SYSC)	Annex B
Client Assets sourcebook (CASS)	Annex C
Collective Investment Schemes sourcebook (COLL)	Annex D

Notes

- E. In Annex A to this instrument, the “notes” (indicated by “**Note:**”) are included for the convenience of readers but do not form part of the legislative text.

Citation

F. This instrument may be cited as UCITS V Level 2 Regulation Instrument 2016.

By order of the Board
[date] 2016

Annex A**Amendments to the Glossary of definitions**

In this Annex, underlining indicates new text. Amend the following definition as shown.

UCITS custodial assets *financial instruments* of a *UCITS* that can be:

- (a) registered in a *financial instruments* account opened in the *depository's* books; or
- (b) physically delivered to the *depository*.

[**Note:** article 22(5) of the *UCITS Directive* and article 12 of the *UCITS level 2 regulation*]

Annex B**Amendments to the Senior Management Arrangements, Systems and Controls
sourcebook (SYSC)**

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

19E UCITS Remuneration Code

...

19E.2 Remuneration policies and practices

...

19E.2.9 R (1) A *management company* must establish a *remuneration* committee if it is significant in terms of:

- (a) its size, or the size of the UCITS that it manages; ~~or~~
- (b) ~~the size of the UCITS that it manages; or [deleted]~~
- (c) the complexity of its internal organisation; ~~or~~ and
- (d) the nature, the scope and the complexity of its activities.

...

Annex C

Amendments to the Client Assets sourcebook (CASS)

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

1 Application and general provisions

...

1.4 Application: particular activities

...

Depositories

...

- 1.4.6B G *Firms acting as trustee or depositary of a UCITS* are reminded of the obligations in *COLL 6.6B (UCITS depositories)* and in the *UCITS level 2 regulation*, which apply in addition to those in *CASS*.

...

6 Custody rules

6.1 Application

...

Depositories of UCITS

- 6.1.16ID R When a *firm* is *acting as trustee or depositary of a UCITS*, the *firm* need comply only with the *custody rules* in the table below:

Reference	Rule
CASS 6.1.1R, CASS 6.1.1BR(3), CASS 6.1.9G, CASS 6.1.16IEG	Application
CASS 6.1.22G to CASS 6.1.24G	General purpose
CASS 6.2.3R, CASS 6.2.3AR, CASS 6.2.3BG, CASS 6.2.7R	Holding of client assets
CASS 6.6.1G to CASS 6.6.5G, CASS 6.6.7R to CASS 6.6.40G, CASS 6.6.42G, CASS 6.6.44R to CASS 6.6.57R(1), CASS 6.6.57R(4) to CASS 6.6.58G <u>CASS 6.6.2R, CASS 6.6.4R, CASS 6.6.7R, CASS 6.6.41AG, CASS 6.6.57R(2A), CASS 6.6.58G</u>	Records, accounts and reconciliations

...

6.6 Records, accounts and reconciliations

...

External custody reconciliations

...

6.6.41A G If a firm acting as trustee or depositary of a UCITS deposits safe custody assets belonging to a client with a third party, under article 13(1)(c) (Safekeeping duties with regard to assets held in custody) of the UCITS level 2 regulation, the firm should seek to ensure that:

(1) the third party provides the firm with adequate information (for example in the form of a statement):

(a) as at a date or dates specified by the firm; and

(b) which details the description and amounts of all the safe custody assets credited to the account(s); and

(2) such information is provided in adequate time to allow the firm to carry out the periodic reconciliations required under article 13(1)(c) of the UCITS level 2 regulation.

...

Notification requirements

6.6.57 R A firm must inform the FCA in writing without delay if:

...

(2A) if it is a firm acting as trustee or depositary of a UCITS and has not complied with, or is materially unable to comply with, the requirements in:

(a) CASS 6.6.2R; or

(b) article 13(1)(b) or 13(1)(c) (Safekeeping duties with regard to assets held in custody) of the UCITS level 2 regulation; or

...

...

Insert the following new row in the appropriate numerical position in Schedule 2 (Notification requirements). The new text is underlined.

Sch 2 Notification requirements

...

Sch
2.1G

<u>Handbook reference</u>	<u>Matter to be notified</u>	<u>Contents of notification</u>	<u>Trigger event</u>	<u>Time allowed</u>
CASS 6.6.57R(2)	...			
<u>CASS 6.6.57R(2A)</u>	<u>Non-compliance or material inability to comply with the requirements in CASS 6.6.2R or article 13(1)(b) or 13(1)(c) (Safekeeping duties with regard to assets held in custody) of the UCITS level 2 regulation</u>	<u>The fact that the <i>firm</i> has not complied or is materially unable to comply with the requirements and the reasons for that</u>	<u>Non-compliance or material inability to comply with the requirement</u>	<u>Without delay</u>
...				

Annex D**Amendments to the Collective Investment Schemes sourcebook (COLL)**

In this Annex, underlining indicates new text.

6 Operating duties and responsibilities

...

6.9 Independence, names and UCITS business restrictions

...

Independence of depositaries and scheme operators

...

6.9.2A G Articles 20 to 24 of the UCITS level 2 regulation set out detailed provisions that must be read alongside COLL 6.9.2G – COLL 6.9.5G.

Appendix 2

Draft Handbook text

Investment funds (securities financing transactions)
instrument 2016

**INVESTMENT FUNDS (SECURITIES FINANCING TRANSACTIONS)
INSTRUMENT 2016**

Powers exercised

- A. The Financial Conduct Authority makes this instrument in the exercise of section 139A (Power of the FCA to give guidance) of the Financial Services and Markets Act 2000 (“the Act”).

Commencement

- B. This instrument comes into force as follows:
- (1) Annex A (Glossary) and Parts 1 of Annexes B and C come into force on [date] 2016.
- (2) The remainder of this instrument comes into force on 13 January 2017.

Amendments to the Handbook

- C. The modules of the FCA’s Handbook of rules and guidance listed in column (1) below are amended in accordance with the Annexes to this instrument listed in column (2) below.

(1)	(2)
Glossary of definitions	Annex A
Collective Investment Schemes sourcebook (COLL)	Annex B
Investment Funds sourcebook (FUND)	Annex C

Notes

- D. In Annex B to this instrument, the “notes” (indicated by “**Note:**”) are included for the convenience of readers but do not form part of the legislative text.

European Union Legislation

- E. Although European Union legislation is reproduced in this instrument, only European Union legislation reproduced in the Official Journal of the European Union is deemed authentic.

Citation

- F. This instrument may be cited as the Investment Funds (Securities Financing Transactions) Instrument 2016.

By order of the Board
[date] 2016

Annex A**Amendments to the Glossary of definitions****Comes into force on [date]**

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

securities financing transactions regulation Regulation (EU) 2015/2365 of the European Parliament and of the Council of 25 November 2015 on transparency of securities financing transactions and of reuse and amending Regulation (EU) No 648/2012 (<http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32015R2365>).

Annex B

Amendments to the Collective Investment Schemes sourcebook (COLL)

In this Annex, underlining indicates new text.

Part 1: Comes into force on [date] 2016

4 Investor Relations

...

4.2 Pre-sale notifications

...

Additional information to be provided in the prospectus or other pre-sale documents on securities financing transactions and total return swaps

- 4.2.5A G (1) The securities financing transactions regulation sets out additional information that:
- (a) an authorised fund manager of a UCITS scheme must include in the UCITS scheme prospectus; and
 - (b) an authorised fund manager who is a full-scope UK AIFM of a non-UCITS retail scheme must make available to investors before they invest.
- (2) COLL 4.2.5BEU and COLL 4.2.5CEU copy out the relevant provisions in that regulation.
- (3) An authorised fund manager who is a full-scope UK AIFM of a non-UCITS retail scheme should publish the information in the scheme's prospectus.
- (4) An authorised fund manager of a UCITS scheme or a non-UCITS retail scheme that does not engage in securities financing transactions or total return swaps is not required to include any additional information in the prospectus or other pre-sale documents.
- (5) For these purposes, securities financing transactions and total return swaps are defined in article 3 of the securities financing transactions regulation.

[Note: A transitional provision applies to COLL 4.2.5AG: see COLL TP 1.38G]

4.2.5B

EU

<u>Transparency of collective investment undertakings in pre-contractual documents</u>	
1.	<u>The UCITS prospectus referred to in Article 69 of Directive 2009/65/EC, and the disclosure by AIFMs to investors referred to in Article 23(1) and (3) of Directive 2011/61/EU shall specify the SFT and total return swaps which UCITS management companies or UCITS investment companies, and AIFMs respectively, are authorised to use and include a clear statement that those transactions and instruments are used.</u>
2.	<u>The prospectus and the disclosure to investors referred to in paragraph 1 shall include the data provided for in Section B of the Annex.</u>
[Note: article 14(1) and (2) of the <i>securities financing transactions regulation</i> and article 3 for relevant definitions]	

4.2.5C

EU

<u>Information to be included in the UCITS Prospectus and AIF disclosure to investors:</u>	
–	<u>General description of the SFTs and total return swaps used by the collective investment undertaking and the rationale for their use.</u>
–	<u>Overall data to be reported for each type of SFTs and total return swaps</u>
	– <u>Types of assets that can be subject to them</u>
	– <u>Maximum proportion of AUM that can be subject to them</u>
	– <u>Expected proportion of AUM that will be subject to each of them.</u>
–	<u>Criteria used to select counterparties (including legal status, country of origin, minimum credit rating).</u>
–	<u>Acceptable collateral: description of acceptable collateral with regard to asset types, issuer, maturity, liquidity as well as the collateral diversification and correlation policies.</u>
–	<u>Collateral valuation: description of the collateral valuation methodology used and its rationale, and whether daily mark-to-market and daily variation margins are used.</u>
–	<u>Risk management: description of the risks linked to SFTs and total return swaps as well as risks linked to collateral management, such as operational, liquidity, counterparty, custody and legal risks and,</u>

	<u>where applicable, the risks arising from its reuse.</u>
–	<u>Specification of how assets subject to SFTs and total return swaps and collateral received are safe-kept (e.g. with fund custodian).</u>
–	<u>Specification of any restrictions (regulatory or self-imposed) on reuse of collateral.</u>
–	<u>Policy on sharing of return generated by SFTs and total return swaps: description of the proportions of the revenue generated by SFTs and total return swaps that is returned to the collective investment undertaking, and of the costs and fees assigned to the manager or third parties (e.g. the agent lender). The prospectus or disclosure to investors shall also indicate if these are related parties to the manager.</u>
<u>[Note: section B of the annex to the <i>securities financing transactions regulation</i> and article 3 for relevant definitions]</u>	

...

8 Qualified investor schemes

...

8.3 Investor relations

...

Additional information to be provided on securities financing transactions and total return swaps

- 8.3.2A G (1) The *securities financing transactions regulation* sets out additional information which an *authorised fund manager* who is a *full-scope UK AIFM* of a *qualified investor scheme* must make available to investors before they invest.
- (2) *COLL 4.2.5BEU* and *COLL 4.2.5CEU* copy out the relevant provisions in that regulation.
- (3) An *authorised fund manager* who is a *full-scope UK AIFM* of a *qualified investor scheme* should publish the information in the *scheme prospectus*.
- (4) An *authorised fund manager* of a *qualified investor scheme* that does not engage in securities financing transactions or total return swaps is not required to include any additional information in pre-contractual documents.
- (5) For these purposes, securities financing transactions and total return swaps are defined in article 3 of the *securities financing transactions*

regulation.

[**Note:** A transitional provision applies to *COLL 8.3.2AG*: see *COLL TP 1.39G*]

...

TP 1 Transitional Provisions

TP 1.1

(1)	(2) Material to which the transitional provision applies	(3)	(4) Transitional provision	(5) Transitional provision: dates in force	(6) Handbook provision coming into force
...					
38	<u>COLL 4.2.5AG</u>	G	The <i>guidance</i> at <u>COLL 4.2.5AG</u> does not apply to the <i>authorised fund manager</i> :	From <u>[commencement date]</u> until 12 July 2017	<u>[commencement date]</u>
			(1) <u>of a UCITS scheme or a non-UCITS retail scheme that is an umbrella, for any sub-fund that was constituted before 12 January 2016; and</u>		
			(2) <u>any UCITS scheme or non-UCITS retail scheme that is not an umbrella and was constituted before 12 January 2016.</u>		
			[Note: article 33(2)(c) of the <i>securities financing transactions regulation</i>]		
39	<u>COLL 8.3.2AG</u>	G	The <i>guidance</i> at <u>COLL 8.3.2AG</u> does not apply to the <i>authorised fund manager</i> :	From <u>[commencement date]</u> until 12 July 2017	<u>[commencement date]</u>

		(1) <u>of a qualified investor scheme that is an umbrella, for any sub-fund that was constituted before 12 January 2016; and</u>		
		(2) <u>any qualified investor scheme that is not an umbrella and was constituted before 12 January 2016.</u>		
		[Note: <u>article 33(2)(c) of the securities financing transactions regulation</u>]		

Part 2: Comes into force on 13 January 2017

4 Investor relations

...

4.5 Reports and accounts

...

Additional information to be included in annual and half-yearly reports on securities financing transactions and total return swaps

- 4.5.8AB G** (1) The securities financing transactions regulation sets out additional information which:
- (a) an authorised fund manager of a UCITS scheme must include in the scheme's annual and half-yearly reports; and
 - (b) an authorised fund manager who is a full-scope UK AIFM of a non-UCITS retail scheme must include in the scheme's annual report.
- (2) COLL 4.5.8ACEU and COLL 4.5.8ADEU copy out the relevant provisions in that regulation.
- (3) An authorised fund manager of a UCITS scheme or a non-UCITS retail scheme that does not engage in securities financing transactions or total return swaps is not required to include any additional information in annual and half yearly reports.
- (4) For these purposes, securities financing transactions and total return

swaps are defined in article 3 of the *securities financing transactions regulation*.

4.5.8AC	EU	<u>Transparency of collective investment undertakings in periodical reports</u>	
		1.	<u>UCITS management companies, UCITS investment companies, and AIFMs shall inform investors on the use they make of SFTs and total return swaps in the following manner:</u>
		(a)	<u>for UCITS management companies or UCITS investment companies in the half-yearly and annual reports referred to in Article 68 of Directive 2009/65/EC;</u>
		(b)	<u>for AIFMs in the annual report referred to in Article 22 of Directive 2011/61/EU.</u>
		2.	<u>The information on SFTs and total return swaps shall include the data provided for in Section A of the Annex.</u>
<u>[Note: article 13(1) and 13(2) of the <i>securities financing transactions regulation</i> and article 3 for relevant definitions]</u>			

4.5.8AD	EU	<u>Information to be provided in the UCITS half-yearly and annual reports and the AIF's annual report</u>	
<u>Global data:</u>			
		–	<u>The amount of securities and commodities on loan as a proportion of total lendable assets defined as excluding cash and cash equivalents;</u>
		–	<u>The amount of assets engaged in each type of SFTs and total return swaps expressed as an absolute amount (in the collective investment undertaking's currency) and as a proportion of the collective investment undertaking's assets under management (AUM).</u>
<u>Concentration data:</u>			
		–	<u>Ten largest collateral issuers across all SFTs and total return swaps (break down of volumes of the collateral securities and commodities received per issuer's name);</u>
		–	<u>Top 10 counterparties of each type of SFTs and total return swaps separately (Name of counterparty and gross volume of outstanding transactions).</u>
<u>Aggregate transaction data for each type of SFTs and total return swaps separately to be broken down according to the below categories:</u>			

–	<u>Type and quality of collateral;</u>
–	<u>Maturity tenor of the collateral broken down in the following maturity buckets: less than one day, one day to one week, one week to one month, one to three months, three months to one year, above one year, open maturity;</u>
–	<u>Currency of the collateral;</u>
–	<u>Maturity tenor of the SFTs and total return swaps broken down in the following maturity buckets: less than one day, one day to one week, one week to one month, one to three months, three months to one year, above one year, open transactions;</u>
–	<u>Country in which the counterparties are established;</u>
–	<u>Settlement and clearing (e.g., tri-party, Central Counterparty, bilateral).</u>
<u>Data on reuse of collateral:</u>	
–	<u>Share of collateral received that is reused, compared to the maximum amount specified in the prospectus or in the disclosure to investors;</u>
–	<u>Cash collateral reinvestment returns to the collective investment undertaking.</u>
<u>Safekeeping of collateral received by the collective investment undertaking as part of SFTs and total return swaps:</u>	
<u>Number and names of custodians and the amount of collateral assets safe-kept by each of the custodians</u>	
<u>Safekeeping of collateral granted by the collective investment undertaking as part of SFTs and total return swaps:</u>	
<u>The proportion of collateral held in segregated accounts or in pooled accounts, or in any other accounts</u>	
<u>Data on return and cost for each type of SFTs and total return swaps</u> <u>broken down between the collective investment undertaking, the manager of the collective investment undertaking and third parties (e.g. agent lender) in absolute terms and as a percentage of overall returns generated by that type of SFTs and total return swaps</u>	
<u>[Note: section A of the annex to the <i>securities financing transactions regulation</i> and article 3 for relevant definitions]</u>	

...

8.3 Investor relations

...

Additional information to be included in annual reports on securities financing transactions and total return swaps

- 8.3.5AB G (1) The *securities financing transactions regulation* sets out additional information which an *authorised fund manager* who is a *full-scope UK AIFM* of a *qualified investor scheme* must include in the *scheme's* annual report.
- (2) *COLL 4.5.8ACEU* and *COLL 4.5.8ADEU* copy out the relevant provisions in that regulation.
- (3) An *authorised fund manager* of a *qualified investor scheme* that does not engage in securities financing transactions or total return swaps is not required to include any additional information in annual reports.
- (4) For these purposes, securities financing transactions and total return swaps are defined in article 3 of the *securities financing transactions regulation*.

Annex C

Amendments to the Investment Funds sourcebook (FUND)

In this Annex, underlining indicates new text.

Part 1: Comes into force on [date] 2016

3 Requirements for alternative investment fund managers

...

3.2 Investor information

...

Additional information to be provided in pre-contractual documents on securities financing transactions and total return swaps

- 3.2.4A G (1) The securities financing transactions regulation sets out additional information which a full-scope UK AIFM must make available to investors before they invest.
- (2) COLL 4.2.5BEU and COLL 4.2.5CEU copy out the relevant provisions in that regulation.
- (3) A full-scope UK AIFM of an AIF that does not engage in securities financing transactions or total return swaps is not required to include any additional information in pre-contractual documents.
- (4) For these purposes, securities financing transactions and total return swaps are defined in article 3 of the securities financing transactions regulation.

...

TP 1 Transitional Provisions

(1)	(2)	(3)	(4)	(5)	(6)
	Material to which the transitional provision applies		Transitional provision	Transitional provision: date in force	Handbook provisions: coming into force
...					
<u>7</u>	<u>FUND 3.2.4AG</u>	<u>G</u>	<u>The guidance at FUND 3.2.4AG does not apply to a full-scope UK AIFM of:</u>	<u>From [commencement date] until 12 July 2017</u>	<u>[commencement date]</u>

			(1) <u>an AIF having one or more sub-funds, for any sub-fund that was constituted before 12 January 2016; and</u>		
			(2) <u>an AIF that does not have sub-funds and that was constituted before 12 January 2016.</u>		
			<u>[Note: article 33(2)(c) of the securities financing transactions regulation]</u>		

...

Part 2: Comes into force on 13 January 2017

3 Requirements for alternative investment fund managers

...

3.3 Annual report of an AIF

...

Additional information to be included in annual reports on securities financing transactions and total return swaps

- 3.3.7B G**
- (1) The securities financing transactions regulation sets out additional information which a full-scope UK AIFM of an AIF must include in the AIF's annual report.
 - (2) COLL 4.5.8ACEU and COLL 4.5.8ADEU copy out the relevant provisions in that regulation.
 - (3) A full-scope UK AIFM of an AIF that does not engage in securities financing transactions or total return swaps is not required to include any additional information in the AIF's annual report.
 - (4) For these purposes, securities financing transactions and total return swaps are defined in article 3 of the securities financing transactions regulation.

Financial Conduct Authority



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