



**JUNE 2009**

**ADVANCED INVESTMENT SCHEMES ADMINISTRATION**

**MARK SCHEME**

## Answer ALL questions in this section

- 1 The requirements for share certificates issued by OEICs under the OEIC regulations 2001 are basically the same as for Unit Trusts. However, there are two exceptions. What are they? (2 marks)

*These two exceptions are as follows:*

- *where the company has more than one class of shares, the certificate must show the class of shares title to which is evidenced by the certificate*
- *instead of authentication by a trustee, the share certificates must be sealed under the common or securities seal of the company or, if the company has not adopted a seal, as authenticated by a director or other authorized officer of the company*

- 2 Outline the unclaimed income provisions of the COLL Sourcebook for a registrar. (2 marks)

*Distribution warrants are normally valid for six months from the payment date. Those not presented for payment by this deadline must be returned to the registrar for re-dating. Often the amount outstanding on the distribution account after six months is transferred (following reconciliation against the paid warrants) to an unclaimed distribution account where it should earn interest for the benefit of all unit/shareholders in the fund.*

*Any distribution payment remaining unclaimed six years after the payment date is transferred to, and becomes part of, the capital property, and neither the unit/shareholder nor payee, if different (or their executors), can reclaim the income (COLL 6.8.4).*

- 3 State TWO level I and TWO level II disclosure requirements of the Pension Fund Disclosure Code jointly issued by the National Association of Pension Funds and the Investment Management Association. (2 marks)

*(Two of each level of disclosure will receive 1 mark)*

**Level 1** covers the manager's policies, procedures and control processes – that is, such items as:

- *how dealing venues (markets, method of dealing) are selected and why;*
- *how brokers are chosen;*
- *issues relating to commissions and the monitoring of dealing efficiency;*
- *conflicts of interest.*

**Level 2** covers specifics relating to the reporting period in question. It deals with such items as:

- *how much (if any) of the portfolio is not being handled or reported on in accordance with the Code;*
- *the fund management fees, and any other fees/charges, being deducted by the fund manager;*

- *the details of other charges such as custody; a comparison of the trading volumes experienced by the fund, the commission charges it has borne, and how they have been spent. This comparison is to be made against the experience of the fund's 'top 10 counterparties' and of the firm's activities as a whole.*

4 State one of the principal forms of corporate actions and provide an example. (2 marks)

*(1 mark for stating form, 1 mark for example)*

*Examples are as follows:*

1. **Mandatory** - *the company's board declares an interim dividend; the investor has no option but to receive payment;*
2. **Voluntary** - *the company receives a take-over bid; the investor must decide whether to accept or not;*
3. **Mandatory with options** - *the company decides to raise additional capital by way of a rights issue; the investor has the right (but not the obligation) to take up the new shares on offer, to sell the rights in the market, or do nothing, in which case the company may sell the rights and pay the investor the proceeds.*

5 Explain the term *benchmarking* and give TWO examples of common benchmarks. (2 marks)

*(1 mark only for explanation, 1 mark for giving 2 examples)*

*A benchmark is a reference or standard level of performance that can be cited in an expression of return objectives set for an in-house or externally-appointed portfolio manager, or used as a comparator for a fund's actual return. (1 mark)*

*The use of benchmarks takes into the area of relative performance measurement, and which benchmark is used is a matter for the parties to agree but it should be both relevant and realistic in the context of the fund's investment objectives and policies. (1 mark)*

*Common benchmarks are one or other of the following:*

- *a relevant equity, bond or other market index;*
- *like funds, also known as peer group or universe comparison; or*
- *a custom benchmark, which may be a composite index or a portfolio. (1 mark)*

6 Outline the main difference between contractual funds and corporate funds of investment schemes. Your answer should focus from both the UK and EU perspective. (2 marks)

*(Outlining the difference will receive 1 mark and stating UK/EU difference will receive 1 mark)*

*A fund may be established as a company, a partnership or a trust or, as with the French Fond Commun de Placement (FCP), have a joint ownership structure without a legal personality.*

- **contractual funds** *set up under contract law or under trust law. In Belgium, France and Luxembourg these are FCPs, whilst in the UK and Ireland they are unit trusts;*
- **corporate funds** *which are structured like a company and have legal personality, i.e., they are a separate legal entity. In French-speaking countries they are constituted as SICAVs whilst in the UK they are OEICs.*

- 7 COLL became the sole sourcebook for UK authorised collective investment schemes from 13 February 2007. State TWO main aims of the FSA's review that led to COLL. (2 marks)

*(1 mark for each aim)*

*The main aims of the FSA's review that led to COLL were to:*

- *promote confidence in authorised collective investment schemes;*
- *create a lighter-touch and a more flexible regulatory regime for schemes aimed at more experienced investors;*
- *harmonise the rules for retail UK unit trusts and UK OEICs;*
- *not compromising investor protection or prejudicing the authorised scheme brand;*
- *generally reduce prescription;*
- *providing durability and greater flexibility for AFMs to provide products to fit the needs of investors;*
- *incorporate the latest European regulatory developments, i.e., the UCITS Product Directive.*

- 8 Potential investors use annual accounts to decide on their investment strategies. State TWO items that they are likely to look for in the accounts before investing. (2 marks)

*(At least any two of the following will receive full marks)*

*These includes:*

- *What is the growth record of the fund?*
- *Are the objectives of the fund the same as those of the potential investor? For example, an older investor is often looking for income rather than growth.*
- *Are the aims of the fund being met?*
- *How successful has management been in achieving performance?*
- *What are the management charges?*
- *Although not required in the contents of the AFM's report, are there any other benefits or features (such as share exchange) available?*

- 9 What is meant by *In Specie* deals in a collective investment scheme? Give an example of why they might happen. (2 marks)

*Due to the costs of investing large sums of cash within a collective investment scheme, the regulations permit a large investor to pay for his units/shares by providing assets rather than cash. (1 mark)*

*Similarly, where a large redemption is placed (normally considered to be 5% of the scheme value), the AFM may require the investor to receive a proportionate share of all assets held by the scheme, rather than cash. (1 mark)*

*Such deals are referred to as 'In Specie' Deals.*

- 10 Give TWO benefits of CREST for the CIS industry. (2 marks)

*(At least any two of the following will receive full marks)*

*There are a number of benefits to be gained by CREST members and AFMs, including:*

- *the system complements the electronic trading system, EMX, introduced in 2000;*
- *the CIS industry is able to use infrastructure that is already proven and very firmly established;*
- *CREST settlement ensures the secure and efficient delivery of stock and payment of cash, reducing the elements of settlement risk in existing procedures (ie, it speeds up delivery of cleared funds for purchases and redemptions);*
- *CREST members are already significant investors in collective investment schemes and have indicated that their transaction volumes will increase as a consequence of the efficiencies described above. As an example, the cost of settlement of unit trust transactions is expected to reduce;*
- *residual settlement is the first phase. Further developments would be required to enable the integration of AUTs and ACDs in CREST's central settlement system allowing the electronic registration of units/shares to take place and provide even greater efficiencies.*

## **SECTION B**

**TOTAL 20 MARKS**

**Answer TWO questions in this section**

- 11 The FSA is concerned at the risk of mis-selling based on unsustainable yields. Outline the FSA's COBS guidance on financial promotion for:

- (a) corporate bond funds; (5 marks)  
(b) with-profit bonds. (5 marks)

### **(a) Corporate Bond Funds**

*(Stating all five items will receive 3 marks and outlining them will receive 2 marks)*

*A firm constructing a financial promotion for corporate bond funds or similar contracts should take account of the following:*

#### **1. Clear description of the risk.**

*Yields offered by bonds often reflect, in part, the risk rating of the issuer. Investment in such bonds brings an increased risk of default on repayment, and this in turn translates into a risk that the capital value of the fund will be affected. Financial promotions for funds which invest in riskier bonds should clearly explain this point to recipients. The prominence and wording of the explanation should reflect both the risk profile of the portfolio held by the fund, and the prominence given to information about the yield on the fund. The main body of the financial promotion should state that the yield or the capital value of the fund (or both) can fluctuate, as the case may be.*

#### **2. Quoting out of date yields.**

*Financial promotions often feature prominently the yield on the fund. In some cases the actual yield being paid at the time the promotion is communicated is materially different to the yield quoted. Owing to lead times, inaccuracies can occur if the market*

*is moving rapidly, but yields several weeks or months out of date are misleading. The promotion should quote the date at which the rate applied. It is misleading for financial promotions with a long shelf life to prominently feature a rate which may become invalid.*

**3. Funds not fully invested.**

*Yield figures should reflect the overall position of the fund allowing for any monies held in cash. Yields quoted on the assumption that the fund is 100% invested in bonds, where a proportion is invested in cash, would be misleading.*

**4. Coupon and effective yields.**

*If a yield figure is to be quoted, then both the effective yield and the coupon yield should be mentioned with equal prominence. This is to ensure that a balanced impression is given of both the short-term and the long-term prospects for the fund. When quoting the effective yield, the main body of the financial promotion should also mention the fact that it is a prediction, and is not guaranteed. A firm should take into account, and explain, any material differences between the yield figures.*

**5. Describing the yield and growth prospects.**

*A firm needs to be careful when describing the future yield or growth prospects of a fund.*

*The prominence and tone given to descriptions of future prospects should reflect a reasonable assessment of the fund taking into account, for example, the effective yield, whether charges are taken from capital, and the general economic climate.*

**(b) With-profits bonds**

*(Outlining at least any three from each (1 and 2) will receive full marks)*

**1. Particular areas of concern about financial promotion of with-profit bonds are:**

*a. failure to make it clear that a whole life with-profits bond is unsuitable as a short-term*

*investment;*

*b. unclear statements as to what factors will determine the cash-in value of the bond;*

*c. reservation of the right to adjust the value of the contract by means such as market value adjustment factors, without adequately explaining the significance or likelihood of such a procedure;*

*d. use of a rate of bonus in a way that implies such a rate will apply;*

*e. quotation of values based on existing bonus rates to lead recipients to anticipate receiving such amounts;*

*f. reference to building society accounts in comparison with the bond without adequately*

*explaining the differences between the two types of investment.*

**2. Quoting a high initial bonus rate may suggest that it is achievable for all investors whereas, for example, the rate may only be available to investors who make a sizeable investment or who make their investment considerably earlier than the closing date. In addition, initial bonus rates are frequently subject to limiting factors, such as:**

*a. establishment charges;*

*b. monthly policy charges;*

*c. fund management or investment charges;*

*d. early surrender penalties or discontinuance charges; and*

*e. market adjustment factors.*

*Therefore where applicable firms should not include terms such as 'guaranteed', 'return' and 'fixed for the first year' without making it clear that the bonus rate may not be achievable.*

- 12 A US investment Trust is keen to expand its operations in the UK. It has learnt that the FSA is the UK's listing authority. However, it does not know the conditions for listing and subsequent behaviour once admitted. Advise the US firm on:

- (a) conditions for listing; (2 marks)  
(b) continuing obligations once admitted; (3 marks)  
(c) the Combined Code on Corporate Governance including its recent review. (5 marks)

**(a) Conditions for listing include:**

*(Stating at least any four will receive full marks)*

- 1. a minimum of three years trading, together with published accounts for the period, subject to waiver at the discretion of the authority which would be the case for start-up enterprises with realistic plans, such as investment trust companies;*
- 2. the directors and senior management having appropriate experience and expertise between them for the successful running of the business;*
- 3. a statement that the company has sufficient working capital for at least the next twelve months;*
- 4. that a company with a shareholder owning 30% or more of the company's shares can operate independently of that shareholder;*
- 5. that the market value of any equities to be listed is at least £700,000;*
- 6. that at least 25% of the company's issued capital will be available to the public.*

**(b) continuing obligations once admitted**

*(Stating at least three from the following will receive 3 marks)*

*Continuing obligations govern both disclosure requirements and behavioural constraints. In general, a company must ensure that price-sensitive information is disclosed to the exchange at the earliest possible time. Examples include announcements of profits (or losses) and declarations of dividends or the arrival or departure of senior executives. Other requirements require notification of a change in the company's financial information, performance of its business or its expectations of performance. More routinely, a company's directors and others must not trade in the company's shares in the two months prior to announcements. (1 mark)*

*To avoid distortions in markets, investors are required to notify companies in which they hold shares when their stake exceeds 3% of that company's share capital, and continue to make notifications of changes until the holding falls below 3%. (1 mark)*

*In addition to the rules applicable to all companies seeking a listing for their shares, the FSA requires investment trust companies to adhere to the following principles:*

- the investment managers must have adequate experience;*
- the investments held must provide an adequate spread of risk;*
- the company must be a passive investor and not control, or seek to control, or be actively involved, in the management of the companies whose shares it holds;*
- the company must have a board of directors that can act independently of its management;*
- the company must not, to a significant extent, be a dealer in investments. (1 mark)*

*The other rules introduced in November 2003 include the requirement to set out risk-related information in offering documents, particularly in relation to investment policy, and that changes to investment policy can only be made with the prior approval of shareholders. (1 mark)*

***(c) combined Code on Corporate Governance including its recent review***

*The Combined Code on Corporate Governance sets out standards of good practice in relation to issues such as board composition and development, remuneration, accountability and audit, and relations with shareholders.*

*All companies incorporated in the UK and listed on the LSE are required under the Listing Rules to report on how they have applied the Combined Code in their annual report and accounts. This requirement does not apply to AIM companies (that is, those companies listed on the Alternative Investments Market). (1 mark)*

*The Combined Code contains broad principles and more specific provisions. Listed companies are required to report on how they have applied the principles of the Code and either to confirm that they have complied with the Code's provisions or, where they have not, to provide an explanation. (1 mark)*

*The Combined Code was published in July 2003. However, between July and October 2005 the Financial Reporting Council (FRC) carried out a review of how the Combined Code was being implemented. The results of that review were published in January 2006. At the same time the FRC began consultation on a small number of possible amendments to the Code. Consequently, a revised Code was published in June 2006. (1 mark)*

*The main changes made to the 2003 Combined Code were:*

- to amend the existing restriction on a company Chairman serving on the remuneration committee to enable him or her to do so where considered independent on appointment as Chairman (although it is recommended that he or she should not also chair the committee);*
- to provide a 'vote withheld' option on proxy appointment forms to enable shareholders to indicate if they have reservations on a resolution but do not wish to vote against it. A 'vote withheld' is not a vote in law and is not counted in the calculation of the proportion of the votes for and against the resolution; and*
- to recommend that companies publish on their websites the details of proxies lodged at a general meeting where votes are taken on a show of hands. (1 mark)*

13 Authorised Corporate Directors (ACDs) and Unit Trust Managers play crucial roles for OEIC and AUT companies.

(a) Outline the legal position of an ACD of an OEIC company. (2 marks)

(b) Discuss the corrective measures for an ultra vires action of an OEIC company director and an AUT manager. (4 marks)

(c) Explain the provisions for vacation and removal of an ACD of an OEIC company. (4 marks)

***(a) legal position***

*(Any two from the following will receive 2 marks)*

*The OEIC is an authorised person and the directors of the OEIC must be fit and proper Under Schedule 5, Paragraph 1(3) of FSMA 2000. (1 mark) An OEIC must have an*

*ACD and any act of a director is binding on the company, even if it is discovered subsequently that there was a defect in his appointment or that the director has acted beyond the powers conferred in the instrument of incorporation. (1 mark) This is to protect outside bodies and persons who would not be aware of the defect and it does not require them to consult public documents, such as the instrument of incorporation, before dealing with the OEIC. This is similar to S.35B Companies Act 1985, relating to companies, though someone who was aware of the defect would not be able to enforce the contract. (1 mark)*

***(b) corrective measures***

*If a director or his associate enters into a contract on behalf of the OEIC which is ultra vires (beyond the powers of) the company, then the transaction is voidable by the OEIC and the director who authorised the transaction must account to the company for any gain he has made, and indemnify the company for any loss or damage resulting from the transaction. (1 mark)*

*It is possible for any ultra vires act of directors to be remedied by the shareholders passing a resolution in a general meeting (i.e., an EGM) rectifying the situation in the case of an OEIC. This is not possible, however, if restitution of any money or other assets, which were the subject matter of the transaction, cannot be made. (1 mark)*

*Any AUT manager and any director of an AUT manager is bound by the terms of the trust deed, prospectus etc. when acting on behalf of the trust. If the manager acts ultra vires he would similarly become liable to the trust for any loss or damage that the trust incurs. (1 mark) Where an appointed director of an AUT manager were found to have acted ultra vires in respect of the AUT, the manager would seek guidance from the trustee. (1 mark)*

***(c) provisions for vacation and removal***

*(Stating at least four circumstances for vacation will receive 2 marks, and stating at least four circumstances for removal will receive 2 marks)*

*The FSA Sourcebook provides that the office of ACD shall be vacated in the following circumstances:*

- upon ceasing to be a director; or*
- notification of termination of that appointment as ACD, the terms of which have been agreed by resolution of the board of directors, as given to the ACD; or*
- the ACD goes into compulsory liquidation; or*
- a receiver is appointed of the undertaking of the ACD; or*
- an administration order is made in relation to the ACD under Section 8 of the Insolvency Act, 1986.*

*In addition to the above, there are provisions in the Investment Management Association's (IMA) Model Instrument of Incorporation for the removal of a director, who:*

- becomes prohibited by law or regulation, eg, is no longer an authorised person; or*
- becomes bankrupt, compounds with creditors or, being a body corporate, a receiver or*
- liquidator is appointed for the winding up of the company; or*
- becomes mentally incapable; or*
- is absent from meetings of directors (or committees of directors) for six months without the sanction of the directors and they resolve that his office be vacated; or*

- has a period stated in his agreement with the company and this comes to an end, or such agreement is summarily terminated; or*
- *may, by ordinary resolution in general meeting be removed before the expiration of his period of office.*

## SECTION C

**TOTAL 30 MARKS**

### Answer ONE question in this section

14 You have been asked to meet a recently recruited manager of investment operations who has limited knowledge of investment schemes available in the UK. Your tasks are to:

(a) outline the key characteristics of the following investment schemes:

- life funds
- pension funds
- investment trusts
- OEICs
- unit trusts
- SICAVs

*(12 marks)*

(b) explain corporation tax implications of income and capital gain for:

- UK life funds
- OEICs of a CIS including applicable tax rates
- Investment trust companies including venture capital trusts

*(12 marks)*

(c) explain a basic tax calculation for a CIS that suffers franked and unfranked income.

*(6 marks)*

#### ***(a) outline characteristics***

*(Outlining each of the six will receive full marks. Stating more characteristics within fewer words will receive better marks. Students may prefer bullet points)*

##### ***i) Life Funds***

*Life funds are themselves pooled funds, normally operated internally by life companies and invested for the purpose of providing benefits to policyholders upon death or some other specific event, or the expiry of a certain period of time. Legal ownership of a life fund's investments is vested with the life company, which has contracts with the ultimate beneficiaries - the policyholders - set out in documents known as 'policies'. Except for unit-linked policies, payment of a policy's benefits is determined by the life company's actuary and in accordance with the terms of each policy. The value of the life fund may rise or fall depending on the value of the assets chosen by the life company investment managers.*

##### ***ii. Pension Funds:***

*Pension funds are established to receive and invest the contributions of individuals and/or their employers in accordance with the terms of a trust set up as a pension scheme. The funds are invested to provide either an actual pension to participants when they retire (a defined benefit scheme) or a sum of money which is used to buy an*

**annuity** (a special form of insurance that provides guaranteed regular payments of income throughout the life of the beneficiary) - a defined contribution or money-purchase scheme. The scheme may also provide for death in service benefits and widows' pensions and is, therefore, frequently linked to a life policy or provided by a life company. In **defined contributions schemes** or **money purchase schemes**, contributions are invested to grow into a pot of money which is realised at a future date - the normal retirement date - at which point it is used to purchase a stream of income, known as an annuity, via a special form of insurance policy. The resulting pension paid via the annuity will depend initially upon the investment performance of the underlying funds rather than the final salary of the employee, and then on the insurance company's assessment of the annuitant's life expectancy and of long-term interest rates at the time of purchase.

### **iii. Investment Trusts**

Investment trusts are not trusts but limited liability companies (PLCs) with shareholders. Their business objective is the holding of investments, typically shares of other companies, for the same purposes as the other pooled funds. Instead of a trustee, an investment trust appoints a custodian, to act as the registered holder of its assets, and a board of directors, to manage the company. Investment management and administration is usually sub-contracted to a specialist fund management company. The shares of investment trusts are themselves traded on the stock exchange. The price of such shares is, therefore, a function of supply and demand in the stock market and may be at a premium or discount to the net asset value per share.

### **iv. Unit Trusts**

A trust is a legal device for separating legal from beneficial ownership of assets, dating back to the days of crusading knights. Unit trusts are the oldest and one of the most common forms of collective investment scheme in the UK. Legally constituted as a trust by a trust deed entered into between a manager and a trustee, their purpose is to provide income and/or capital growth from a portfolio of investments acquired with the pool of funds contributed by the unit holders. The trustee is the legal owner of the trust's assets but is obliged by the deed to deal with them in accordance with the manager's instructions and to ensure that the capital and income of the trust are applied for the benefit of the beneficial owners, the unit holders. The price of individual units must be determined according to regulations as a fair price and based upon the value of the underlying assets and income of the trust, plus or minus permitted charges. The price of units is usually based on market dealing prices and separate prices are calculated for the buying and selling of units, using the market's offered and bid prices – known as '**dual-pricing**'.

### **v. Open-Ended Investment Companies (OEICs)**

OEICs are the newest form of collective investment scheme permitted in the UK, combining features of both unit trusts and investment trusts. Although OEICs have some features that are common to all companies, they are not governed by the Companies Acts, as are investment trusts, but are established as investment companies with variable capital (ICVCs) under special legislation drawn up under the Financial Services and Markets Act. They may be established as a **single fund company** or as an **umbrella company** with two or more sub-funds. Like an investment trust, an OEIC is managed by its board of directors, one of whom is the **Authorised Corporate Director (ACD)** taking responsibility for principal operating matters. The ACD can be the sole

director, making it the equivalent of the manager of the unit trust. Assets are held by a depositary, who also has some responsibilities of oversight of the ACD, though not the supervisory responsibilities of the trustee of a unit trust.

#### **vi. SICAVs**

Literally translated from the French, a **SICAV** is an investment company with variable share capital, in other words a type of open-ended investment fund in which the amount of capital in the fund varies according to the number of investors. It is very similar to the UK's OEIC or ICVC and is the most common legal form for investment vehicles in Europe, with France, Luxembourg and Dublin being the most prolific centres of administration. The SICAV is also well known and used in Belgium and Italy where it is called *Societa di Investimento a Capitale Variabile*. A SICAV is a legal entity, with a board of directors to oversee the fund; this contrasts with a UK OEIC which commonly has only a single director, the ACD.

### **(b) corporate tax implications**

#### **i. Life Funds**

Taxation within a life fund is complex, but summarises as follows:

- UK dividend income is taxed at the rate of 10%, which is covered by the tax credit accompanying receipt of the dividend; (1 mark)
- Capital gains made within the fund are subject to corporation tax; (1 mark)
- Premiums paid under a life policy are not eligible for tax relief but payment under a life policy is normally exempt from capital gains tax, unless the individual making a gain on disposal:

a. is not the original beneficial owner; or

b. bought the policy as distinct from it being acquired as a gift or a mortgage. (2 marks)

(Stating at least any three from the CIS will receive 3 marks and any one from applicable tax rate will receive 1 mark, 3+1 = 4 marks)

#### **ii. CIS**

The *Open-Ended Investment Companies (Tax) Regulations 1997* provide, subject to certain modifications and exceptions, that OEICs should be taxed in the same way as authorised unit trusts under the *Taxes Act* and the *Taxation of Capital Gains Act 1992 (TCGA)*. (1 mark) Accordingly, each type of CIS (OEIC and AUT) is taxed as set out in *S.468(1)* of the *Taxes Act*, as if:

- it is an ordinary company (formed under the *Companies Act*) resident in the UK; and
- the rights of the unit/shareholders are as shareholders in such an ordinary company. (1 mark)

If the scheme is an umbrella type scheme (which has two or more sub-funds), each sub-fund is treated for tax purposes as if it were a separate scheme, and the umbrella company is not considered as a separate taxable entity. (1 mark)

Unlike unit trusts where the trustee is seen as the taxpayer, the depositary of an OEIC is not. It is the OEIC that is the taxpayer and the ACD is responsible for the completion and submission of all tax returns to HMRC on behalf of the OEIC. (1 mark)

#### **APPLICABLE TAX RATES**

Under the *Finance Act 1994*, authorised CISs are divided into two categories for tax purposes, distinguished by the nature of their investments. At present both categories are subject to corporation tax of 20% on their taxable profit. The tax treatment of distribution of income to investors is different however. (1 mark)

| Category of CIS   | Tax treatment of income distributions  |
|---|--|
| a) less than 60% of property in interest bearing assets (eg, gilts) | If (a) applies at any point during the distribution period, the CIS must opt to pay a dividend distribution. Such a distribution carries a 10% tax credit.                 |
| b) 60% or more of property in interest bearing assets               | If (b) applies throughout the distribution period, the CIS may opt to pay an interest distribution. Such a distribution is subject to income tax at the lower rate of 20%. |

*There is a general obligation on the payer of the yearly interest to deduct at source income tax at the appropriate rate on the gross amount payable. This requirement does not apply to certain interest distributions to non-resident unit/shareholders who have completed the appropriate declaration and the income may be paid gross. (1 mark)*

### **iii. ITCs**

*UK resident ITCs are taxed like any other company. Unfranked income, net of administration and management charges, including the cost of any borrowing, is subject to corporation tax, generally at 30%. Investors holding ITC shares are treated like shareholders in any other sort of company. Dividend income is received with a 10% tax credit and no further amount of tax is payable by a non- or basic-rate taxpayer. However, the credit cannot be recovered by non-taxpayers, and higher-rate payers will have to pay a further 32.5%. Gains made on disposal of ITC shares will be taxable at 18%, after the amount of gain has been reduced for indexation, taper and exemption reliefs. (2 marks)*

*Special rules apply to Venture Capital Trusts (VCTs), whereby investors can obtain income tax relief of 30% on up to £200,000 of their initial investment, receive any income free of tax (but tax credits cannot be reclaimed) and capital gains are tax free. For the amount of VCT investment made before 6 April 2004, the equivalent gains made on other investments may be deferred until ultimate realisation of the VCT investment. (2 marks)*

### **(c) basic tax calculation**

*(Showing basic computation will receive 3 marks and the treatment of franked income will receive 2 marks and an example will receive 1 mark, 3+2+1=6 marks)*

*The CIS's account to HMRC for corporation tax on any surplus of their other (unfranked) income over management expenses and after offsetting income tax and foreign withholding tax deducted from income before receipt. The basic computation is:*

- 1. Unfranked income, ie, overseas income, interest income, underwriting commission etc, less;*
- 2. Expenses of management and, if allowable, any amortisation of capital outlays allowable as deductions for tax purposes, equals;*
- 3. Net income subject to corporation taxation.*

*The actual amount of tax to be paid will normally be reduced by credit for foreign taxes withheld from income distributions where double taxation agreements exist (but not the foreign scheme's underlying 'corporate' tax) or by deduction as an expense of management. (3 marks)*

*The following is a simple example of a tax calculation in respect of a fund paying a dividend distribution. (1 mark)*

**Tax calculation if a CIS has suffered no overseas tax**

|                                 | £(000s) | £(000s)    |
|---------------------------------|---------|------------|
| <b>Unfranked income:</b>        |         |            |
| Interest on debt securities     | 20      |            |
| Bank deposit interest           | 80      |            |
| Underwriting commission         | 20      | 120        |
|                                 |         |            |
| <b>Less expenses:</b>           |         |            |
| AFM's fee                       | (10)    |            |
| Depository's fee                | (5)     |            |
| Safe custody charges            | (5)     | (20)       |
|                                 |         |            |
| <b>Income before taxation</b>   |         | <b>100</b> |
|                                 |         |            |
| Corporation tax at 20%          |         | (20)       |
| <b>Net distributable income</b> |         | <b>80</b>  |

If the fund has received **any franked income** then the amount of that income (excluding the 10% tax credit) is added to the net distributable income available from the after-tax computation of unfranked income less charges shown above, and the resultant total amount is distributed or allocated to unitholders. (2 marks)

- 15 You are the compliance officer of an investment management company. Your CEO approaches you to seek advice on three issues.
- Your CEO informs you that another firm's equity funds are being promoted using historic comparisons between its funds' absolute returns and your funds' time-weighted returns for the same period, based on data supplied by your compliance department. Explain how time-weighted returns are calculated and why they are useful for the investor. (10 marks)
  - Explain the requirements of FRS 27 for life assurance and life funds, and FRS 17 for pension schemes. (10 marks)
  - Explain the settlement method of investor transactions by AFMs including alternative settlement methods. (10 marks)

**(a) Time-weighted returns**

*The time-weighted return is essentially the geometric mean of the series of returns for periods during the overall period that starts when cash moves into or out of the fund and ends immediately prior to the next movement. It smoothes out the distortion caused by cash flows by placing equal weight on the returns calculated for each sub-period.*

*The formula can be expressed in a number of ways (both 'Modified' and 'Original' Dietz*

*methods are commonly used as simpler approximations) but using the Greek letter  $\pi$  (pronounced pi) to signify product or that the individual returns are multiplied together, the expression is:*

$$r = [ \pi \text{ VALUE AT END OF SUB-PERIOD} - 1 ] \times 100\%$$

$$\text{VALUE AT START OF SUB-PERIOD} + CF$$

*Applying this to an example (students can make their own example here, this is the one*

quoted in the study-guide but any figures are acceptable):

(The fund started the period at £1,000,000, experienced an inflow of £50,000 after 3 months and a further £25,000 3 months later, closing the 12 months period at £1,125,000 and assuming no growth occurred in the first 3 months, ie, the portfolio was worth the original £1,000,000 at the time of the first inflow and the fund was worth £1,060,000 immediately prior to the second in-flow:)

$$r = [(1+0) \times (1+0.009524) + (1+0.03687)] - 1$$

$$r = 0.046745 \text{ or } 4.67\%$$

This is marginally lower than the money-weighted return but, unlike the money-weighted

return, can validly be compared with the time-weighted return of other funds.

Although, for simplicity, these examples use an overall period of one year, it is generally

recognised that to obtain statistically significant results the minimum set of data should be quarterly returns over a four year period.

The calculations can be more complex still, for example:

- An international fund, invested in assets denominated in different currencies, will have two elements to the overall return expressed as a sterling return: one the actual return expressed in the foreign currency, the other the return on the currency itself, ie, the movement in exchange rates.
- Funds invested across a number of asset classes will have a different return for each class and determine the overall return to be the weighted sum of the individual returns.
- A diversified international fund will require a combination of the above in order to produce a meaningful and useful measure of performance.

While it is perfectly straightforward to compute an absolute return by expressing the final

value as a % growth or decline on the original £1,000, it is conventional for the data to be presented in £ terms - for example, what £1,000 invested 5 years ago is worth today, with the basis quoted as being "offer to bid, income reinvested". It is for this reason that managers of a growing fund will set their selling (bid) dealing price (for investors who wish to redeem their holdings) at a level which is a spread down from the buying (offer) price, rather than at the lower minimum selling price.

While the return for a given period is an interesting and vital statistic, it says nothing about consistency or reliability of performance. For instance, for a given 12 month period, a fund may show an annualised return of 12½%, growing £1,000,000 to £1,125,000.

To take performance measurement a stage further, this 12 month return should be compared to previous returns of the 12 months measured, say, quarterly to the end of each quarter. If the immediate past five quarters produced 20%, 10%, 5% and 15%, it is apparent that, for some reason, the portfolio manager is unable to achieve a steady rate of return from quarter to quarter for successive 12 month periods.

Thus, our marketing department can use the benefits of the longer timescale to show our

better performance and to demonstrate the problems with other methods if they so wish.

### **(b) FRS 27 and FRS 17**

(Stating at least five requirements from each FRS will receive five marks)

**FRS 27** requires:

- For large UK with-profits life assurance businesses falling within the scope of the FSA's realistic capital regime, liabilities to policyholders are required by the FRS to be

measured on the basis determined in accordance with that regime, subject to adjustments specified in the FRS. Further adjustments are made to related assets and deferred tax for consistency with the measurement of the realistic liabilities, and the resulting effect on profit and loss account is offset by a corresponding transfer to the fund for future appropriations or, in the case of a mutual, to retained surplus. (1 mark)

- For all entities within the scope of the FRS, the fund for future appropriations (FFA) must be separately presented on the balance sheet and an explanation given of a negative FFA balance. (1 mark)

- The FRS restricts the recognition of the value of in-force business, but permits entities that currently recognise such value to continue to do so, subject to limitations on the way this value may be determined. (1 mark)

- A capital statement is required setting out the total available capital for sections of the life assurance business of the entity. (1 mark)

- The capital statement is required to be supported by information on regulatory capital requirements or management's capital targets, the basis of determining regulatory capital, the sensitivity of liabilities and capital to changes in market variables and key assumptions, and the entity's capital management policies. An appendix to the FRS sets out an example of a capital statement and its supporting narrative. (1 mark)

- Information is also required to be disclosed on the assumptions used in the measurement of liabilities, and the terms and conditions of options and guarantees relating to life assurance contracts. For those liabilities to policyholders resulting from options and guarantees that are not measured at fair value or on a statistical basis that takes into account all possible outcomes of the option or guarantee, entities must provide additional information on the nature and extent of the options and guarantees and the possible liabilities that may arise. (1 mark)

- A movements table is also required to show the changes in capital from one reporting date to the next. (1 mark)

### **FRS 17**

FRS 17 has particular application to defined benefit schemes as it sets out the accounting treatment for retirement benefits such as pensions and medical care during retirement. It replaces SSAP 24 'Accounting for pension costs' and UITF Abstract 6 'Accounting for post-retirement benefits other than pensions'.

The main requirements of FRS 17 are:

1. pension scheme assets are measured using market values; (1 mark)

2. pension scheme liabilities are measured using a projected unit method and discounted at an AA corporate bond rate; (1 mark)

3. the pension scheme surplus (to the extent it can be recovered) or deficit is recognised in full on the balance sheet; (1 mark)

4. the movement in the scheme surplus/deficit is analysed into:

- a. the current service cost and any past service costs; these are recognised in operating profit;

- b. the interest cost and expected return on assets; these are recognised as other finance costs;

- c. actuarial gains and losses; these are recognised in the statement of total recognised gains and losses. (1 mark)

FRS 17 includes the following transitional arrangements:

1. for accounting periods ending on or after 22 June 2001, closing balance sheet information (no comparatives required) is to be given in the notes only; (1 mark)

2. for accounting periods ending on or after 22 June 2002, opening and closing balance sheet information and performance statement information for the period (no comparatives required) is to be given in the notes only; (1 mark)
3. for accounting periods beginning on or after 1 January 2005, the standard is fully effective; (1 mark)
4. early adoption is encouraged. (1 mark)

**(c) Settlement methods**

*(Explaining method of settlement will receive 6 marks and alternative settlement method will receive 4 marks)*

**Methods of Settlement**

*Once a person has entered into a contract to buy or sell units/shares the next stage is for the contract to be settled. This requires the amount of money due under the contract to be paid and the legal title to the units/shares to be transferred.*

*The AFM must describe the arrangements for the sale and redemption of units/shares in the prospectus. This will normally include the terms on which settlement of transactions takes place. (1 mark)*

*The regulations require redemptions to be settled on the fourth business day following the trade (known as T+4) or once the AFM has received all the duly executed instruments and authorizations to effect the transfer of title to the units/shares back to the AFM. For example, a form of renunciation signed by the unit/shareholders. (2 marks)*

*For redemptions, the AFM must ensure that it remits the proceeds to the first-named investor (who is no longer shown as owner of the units/shares that have been sold), as failure to make payment would be a breach of regulations. For sale transactions (units/shares purchased by the investor) the period of settlement is not specified by the regulations but may be cash (i.e., same day settlement) with order or, typically where telephone dealing takes place, on the same T+4 basis. (1 mark)*

*The AFM will normally chase the investor for payment if the funds are not received by T+4. If payment remains outstanding the AFM is entitled to cancel the transaction as the investor has failed to satisfy his requirement under the contract. The units/shares are removed from the registered holding of the investor and returned to the manager's box on the date that the transaction was cancelled. (1 mark)*

*The traditional method of payment is for the payment to be remitted by the investor using a cheque or a telegraphic transfer. In the case of regular purchases through a savings plan the investor may pay via direct debit claimed by the fund managers, or by giving their bank a standing order. (1 mark)*

*As a result of more business being done over the telephone and the introduction of websites facilitating the purchasing of units/shares via the internet, a growing number of AFM groups accept payment by means of debit cards. The investor simply provides their debit card number at the time of dealing. (1 mark)*

**Alternative Settlement Methods**

*There is growing interest by institutions in 'straight-through processing' (STP) which links dealing instructions, the provision of registration/investor details and the settlement of transactions through an electronic system. The initial investment in such systems is expensive and the business case for any particular product provider needs to be strong to justify the expense. However, as the number of transactions in investment schemes being intermediated (ie, are placed through advisers and institutions such as fund supermarkets) grows, so does the interest in such systems. (1 mark)*

*The UK has seen the development of EMX as a means for delivering electronic dealing messages and certain other information but it is not yet widely used for settlement. In Europe a combination of systems, such as Euroclear and banking payment messaging via the SWIFT network, have enabled some development of STP. (1 mark)*

*Another method of making payment in the UK, particularly for institutions, is to use the CREST system. In 1999, Euroclear UK & Ireland introduced new functionality to facilitate the settlement of CIS transactions via CREST, using a process referred to as a 'residual settlement transaction'. This provides secure delivery of physical stock and the use of CREST's assured payment mechanism. (1 mark)*

*CREST settlement of CIS transactions follows a different process to settlement of other securities transactions through CREST's central settlement system. CIS investment deals are described within CREST as residual. With residual securities, the unit/share certificate and the stock transfer form are passed from seller to buyer (normally via their brokers) either inter-office or through the CREST Courier and Sorting Services (CCSS).*

*Residual settlement of CIS investment differs from residual settlement of corporate securities because in the normal course one of the parties to a residual CIS transaction will always be the AFM. This means that settlement risk can be reduced, since the AFM can ensure that transfer of title is co-ordinated with payment. (1 mark)*

## **SECTION D**

**TOTAL 30 MARKS**

### **Answer ONE question in this section**

- 16 You have been asked to make a presentation to a Local Authority Pension Committee about common performance standards. Prepare a presentation that outlines the benefits of common performance standards of investment and explain in detail the evolution of one such common performance standard. (30 marks)

*(Benefits will receive 5 marks and the evolution will receive 25 marks)*

*The benefits include:*

- creates a 'level playing field' - individual portfolio managers can be judged on their merits, not on their presentation;*
- facilitates comparisons - by providing uniform data, clients can readily make like-for-like comparisons, whether of funds or of fund managers;*
- introduces independence in the measurement and verification process;*
- assists the adoption of best practice throughout the industry;*
- discourages firms from issuing misleading presentations or advertisements.*

*The evolution:*

*Measuring the investment performance of money managers is a critical part of the investment process. Consistent reporting, analysis and measurement enable investors to improve their understanding of managers' track records and help them to make better manager choices.*

*The UK Investment Performance Standard (UKIPS) is part of a global initiative to standardise the way that investment information is presented. If fund managers' performance is to be open to scrutiny, their investment returns need to be calculated and disclosed on a consistent basis.*

*Taking the lead in establishing standards in the UK is the National Association of Pension Funds (NAPF). In July 2003, NAPF published an endorsement of UK standards issued by the Investment Performance Council of the Association for Investment Management and Research (AIMR), now renamed the Chartered Financial Analyst Institute (CFA Institute):*

*The UKIPC has without amendment adopted an edition of Global Investment Performance (GIPS) entitled 'The UK Investment Performance Standards' (UKIPS). This standard is sponsored and endorsed by the Association of British Insurers, the Association of Consulting Actuaries, the Investment Management Association, the National Association of Pension Funds, the Society of Pension Consultants and the UK Society of Investment Professionals. In autumn 2001 the IPC of the AIMR endorsed UKIPS as a country version of GIPS.*

*A further development is that, effective 1 January 2006, the AIMR-PPS (Performance Presentation Standards) converged with the GIPS standards.*

*GIPS is put out by the CFA Institute, formerly known as the Association for Investment Management and Research (AIMR).*

*GIPS stands for Global Investment Performance Standards, which are ethical standards to be used by investment managers for creating performance presentations that ensure fair representation and full disclosure of investment performance results.*

*The CFA Institute is based in Charlottesville, Virginia, USA, with offices for Asia in Hong Kong, and for Europe in Canary Wharf, London. It has produced a number of codes for its members and others in an effort to raise standards across the globe.*

*On 4 February 2005, the CFA Institute Board of Governors approved the revised Global*

*Investment Performance Standards, or GIPS®, which create a single global standard of investment performance reporting and increase minimum standards worldwide. The revised GIPS Standards represent the most comprehensive and significant upgrade to the Standards since their introduction in 1999.*

*CFA Institute (formerly known as the Association for Investment Management and Research or AIMR) recognised the need for a global set of performance presentation standards, and in 1995, it sponsored and funded the Global Investment Performance Standards (GIPS®) Committee to develop a single standard for presenting investment performance.*

*In February 1999, the GIPS Committee finalised the GIPS Standards and presented them to the AIMR Board of Governors, who formally endorsed them. Although CFA Institute is funding and administering the activities of the GIPS Standards, the success of the Standards is the result of an alliance among experts from a variety of fields within the global investment industry.*

*With the release of the GIPS Standards in 1999, the GIPS Committee was replaced by the Investment Performance Council (IPC) which serves as the global committee responsible for the Standards. It consists of 36 members from 15 countries. The council members come from firms of all sizes and specialise in mutual funds, private wealth management, insurance, pension funds, private equity and venture capital, real estate, investment consulting services, and performance measurement and verification.*

*The principal goal of the IPC is to have all countries adopt the GIPS Standards as the standard for investment firms seeking to present historical investment performance. The IPC envisions GIPS compliance acting as a 'passport' that allows firms to enter the arena of investment management competition on a global basis, and to compete on an equal footing. The GIPS passport allows level playing field and promote global competition among investment firms which will, in turn, provide prospective clients*

*with a greater level of confidence in the integrity of performance presentations, as well as the general practices of a compliant firm.*

*In order to achieve this goal, over the past five years, the IPC has used a dual approach convergence strategy to (1) transition the existing local standards to the GIPS Standards and (2) evolve the GIPS Standards to incorporate local best practices from all regional standards so as to form one improved standard for investment performance calculation and reporting. The IPC strongly encourages countries without an investment performance standard in place to accept the GIPS Standards as the local standard and translate them into the native language when necessary, thus promoting a 'translation of GIPS' (TG).*

*However, to effectively transition existing regional standards, the IPC acknowledges that some countries need to adopt certain long-standing requirements in addition to the GIPS standards. Since 1999, the IPC has promoted the 'Country Version of GIPS' (CVG) approach, whereby countries that had existing performance standards could adopt the GIPS Standards as the core. This core was only to be supplemented to satisfy local regulatory or legal requirements and well-established practices. Any other differences were to be transitioned out of the CVG so that the CVG would converge with the GIPS Standards. The CVG model has facilitated the movement of the industry toward one standard for the calculation and presentation of investment performance.*

*By revising the GIPS Standards, it is the IPC's hope that CVGs will no longer be necessary. Instead, all CVG-compliant firms will be granted reciprocity for periods prior to 1 January 2006. Their CVG-compliant history will satisfy the GIPS requirement to show at least a five-year track record. In this way, firms from all countries will comply with one standard, the GIPS Standards, from 1 January 2006 and the industry will achieve convergence of all standards.*

*From this it can be seen that, to all intents and purposes, there is now only one source of standards - GIPS - and any differences between GIPS and UKIPS are to be removed. The actual standards are summarised by CFA Institute in its GIPS document, as follows:*

*The GIPS standards are divided into eight sections that reflect the basic elements involved in presenting performance information:*

- 1. fundamentals of compliance,*
- 2. input data,*
- 3. calculation methodology,*
- 4. composite construction,*
- 5. disclosures,*
- 6. presentation and reporting,*
- 7. real estate, and*
- 8. private equity.*

*The provisions for each section are divided between requirements, listed first in each section, and recommendations. Firms must meet all the requirements to claim compliance with the GIPS Standards.*

*Firms are strongly encouraged to adopt and implement the recommendations to ensure that the firm fully adheres to the spirit and intent of the GIPS Standards.*

- 17 A recently appointed supervisor wants to know more about the Authorised Fund Manager's (AFM's) Report, and the Statement of Recommended Practice (SORP). You have been asked to state the items that must be specified in the AFM's Report, and explain the content items of the SORP that must be included in the financial statements for authorised funds for an annual and interim reporting period. (30 marks)

*(Specifications of the AFM's report will receive 5 marks, specification of all 8 SORP items will receive 4 marks, and the explanation of at least seven (3x7=21) will receive 21 marks, 5+4+21=30 marks in total)*

*(Stating at least six from the following will receive 3 marks)*

*The AFM's report must specify the following:*

- *confirmation of the names and addresses of the main parties (the AFM, trustee/depositary, registrar, investment advisor, auditor, and any standing independent valuer for a scheme investing in immovable property);*
- *the names of any directors other than the AFM (for an OEIC);*
- *a statement of the scheme's authorised status;*
- *the investment objectives of the scheme and its policy for meeting those objectives;*
- *a review of the investment activities during the reporting period;*
- *details of any fundamental or significant changes to the scheme's operations made since the last report; and*
- *any other information necessary to enable investors to make an informed judgement on the activities of the scheme during the period and the results as at the end of the period.*

*(Stating at least two from the following points will receive 2 marks)*

*Other requirements apply to certain types of fund. An OEIC must name any directors appointed in addition to the AFM, and state that investors are not liable for the debts of the scheme. (1 mark)*

*For a UCITS scheme that invests in other schemes the report must include a statement detailing the maximum proportion of management fees charged to the scheme itself and to the schemes in which it invests. (1 mark)*

*For an umbrella scheme the report must provide the above information in respect of each sub-fund and also clarify that, as the sub-funds are not legal entities, any shortfall in one sub-fund might be met from the assets of other sub-funds. (1 mark)*

*(Stating all eight from the following will receive 4 marks)*

*The SORP specifies that the financial statements for an annual and interim reporting period must include the following items:*

- 1. statement of total return;*
- 2. statement of movements in unit/shareholders' funds;*
- 3. portfolio statement;*
- 4. balance sheet;*
- 5. summary of material portfolio changes;*
- 6. statement of the material accounting policies used in preparing the financial statements;*
- 7. further details in notes to the financial statements;*
- 8. distribution table.*

*(Each explanation will receive 3 marks, 3x7=21 marks)*

*These are discussed as follows:*

### **1. Statement of Total Return**

*This statement summarises the net investment gains or losses, together with the income earned after tax and expenses. It identifies that part of the total return that is to be distributed in accordance with the regulations.*

*The statement of total return must show:*

- *net gains/losses on investments during the period;*
- *other gains/losses (eg, currency gains/losses);*
- *net income/expenses after taxation for the period showing separately, gross income, total expenses and the tax charge;*
- *total return for the period;*
- *distributions;*
- *net increase/decrease in unit/shareholders' funds from investment activities.*

*The Statement of Total Return must include comparative figures for the equivalent period last year.*

### **2. Statement of Movement in Unit/Shareholders' Funds**

*The statement of movements in unit/shareholders' funds should summarise the movements in the total value of the fund. This statement reconciles the changes in net assets during the period in summary form. It draws on the statement of total return for the net increase or decrease in assets attributable to the investment activities and shows the extent to which the fund has grown or contracted as a result of the creation or cancellation of units/shares.*

*The statement of movements in unit/shareholders' funds should be presented on the same page of the financial statement of total return, thereby providing unit/shareholders, on one page, with a summary of the principal features of the scheme's results for the period. It should also include comparative figures for the previous period, ie, to the previous report figures whether final or interim.*

### **3. Statement of Assets and Liabilities (or Portfolio Statement)**

*This statement essentially lists all the investments of the scheme, reconciling the total to the total net asset value of the scheme as per the statement of movement in unit holders' funds and the balance sheet. It must show the portfolio according to the different sectors the assets comprise (such as by country or by industrial/market sectors such as retail, pharmaceuticals, manufacturing, etc).*

*The statement must show the following:*

- *the number, quantity, description and value of each asset;*
- *the percentage of value of property of the scheme each holding represents;*
- *any instruments relating to indebtedness;*
- *the net current assets of the scheme;*
- *the total value of all assets in the scheme.*

*The portfolio statement should detail and distinguish between assets that are approved or unapproved securities, and also distinguish those that are admitted to official stock exchange listing. It is considered that a geographical analysis of the portfolio would give an adequate indication of the official stock exchanges on which the securities are listed, provided any individual securities traded on a different exchange (or not listed) are clearly indicated.*

*The Portfolio Statement must include comparative figures for each sector as at the end of the previous report period, though need not provide comparative figures for each security.*

#### **4. Balance Sheet**

*The Balance Sheet provides a consolidated statement of the scheme's assets and liabilities, including:*

- *total investments valued at mid-market price;*
- *cash and bank balances;*
- *amounts payable/receivable to/from brokers for buying/selling securities; and*
- *any other sundry debtors and creditors (amounts due or payable).*

#### **5. Summary of Material Portfolio Changes**

*Significant changes in the disposition of the assets of the scheme should be provided. The summary of material portfolio changes should identify the value of purchases or sales of a security exceeding 2% of the net assets of the scheme at the start of the period. In any event a minimum of the 20 largest purchases and 20 largest sales must be shown. To provide information about the extent of investment activity, the total cost of purchases and net proceeds from sales of investments during the period should also be disclosed.*

#### **6. Notes to the Financial Statements**

*The notes should include any other information required by the OEIC Regulations or the FSA CIS Sourcebook, together with the accounting policies used, and any information that is required for the accounts to give a true and fair view.*

*The Typical Unit Trust Annual Report and Financial Statements included in the SORP gives details of what should typically be included (items such as the distribution policy, treatment of income, application of equalisation, etc.).*

*Disclosure should also be made of the aggregate underwriting commitments at the balance sheet date. The aggregate commitment on partly paid shares, nil paid shares and warrants should be disclosed.*

#### **7. Distribution Table**

*The financial statements include a table detailing the distribution payable or allocated for both Group 1 and Group 2 units/shares of each unit/share class in issue. The table shows the following items in pence per unit/share:*

- *gross income (for interest distributions);*
- *income tax (for interest distributions);*
- *net income;*
- *equalisation;*
- *distribution payable; and*
- *distribution paid in the equivalent period (annual or interim) 12 months earlier.*

*If there is a significant difference between net income shown in the statement of total return and the amount distributed, managers may wish to include an explanation of the difference in the notes, but this is not compulsory.*