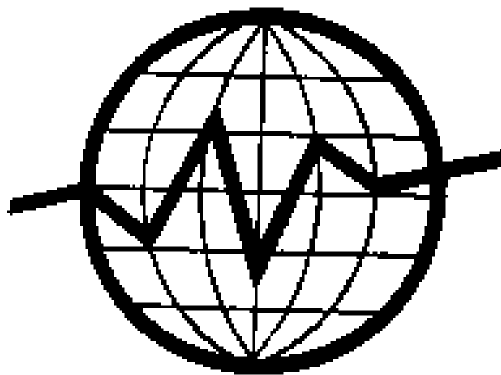
REPORT ON INVESTMENT MANAGEMENT



INTERNATIONAL ORGANIZATION OF SECURITIES COMMISSIONS

October 1994

PRINCIPLES
FOR THE REGULATION OF

COLLECTIVE INVESTMENT SCHEMES

and

EXPLANATORY MEMORANDUM

INTRODUCTION

In February 1993, at its meeting in Trinidad and Tobago, the Technical Committee created a Working Group with a mandate to identify equivalence in the regulatory framework for collective investment schemes, for the purpose of eliminating barriers to cross-border distribution, and ways to enhance regulatory co-operation in relation to collective investment schemes and their operators.

This Report, which has been adopted by the Technical Committee, is the Group's response to the first part of that mandate, addressing the relevant issues in relation to collective investment schemes investing primarily in securities. It does not cover schemes investing in property/real estate or venture capital, or closed end schemes, nor schemes that invest primarily in derivatives.

In carrying out this part of its mandate the Group undertook an analysis of the relevant international laws and practices. While the analysis demonstrated that member countries take a variety of approaches to regulating collective investment schemes, the Group identified a number of fundamental regulatory concepts that exist in each system. From these fundamental concepts the Group developed a set of core Principles that are considered important by member countries for the regulation of collective investment schemes falling within the scope of the Group's consideration.

In identifying the Principles it was recognised that, while there are general concepts common to most regulatory systems, there may be alternative approaches to the implementation of those concepts in seeking to achieve comparable levels of investor protection. The explanatory memorandum that accompanies the Principles illustrates by reference to different jurisdictions that there are a number of different ways of regulating collective investment schemes to achieve investor protection.

Neither the Principles nor the memorandum is intended to endorse the efficacy of any one system over another. Nothing in the Principles is in any way binding on any member country.

The Principles should provide guidance to member countries in their regulation of collective investment schemes, which is particularly important in the context of the globalisation of securities markets and investment advisory services. Development of the Principles will enhance co-operation among member countries in supervising and overseeing the increasingly internationalised investment management industry. The Principles will also provide guidance for industry participants on the standards to be achieved by collective investment schemes seeking to access international markets.

As well as providing for greater understanding of member countries' systems of regulation, the Principles provide a foundation for the development of existing and future relationships among members. To the extent permitted by their legal and regulatory frameworks, member countries should be able to take the Principles into account in any facilitation of the marketing of foreign collective investment schemes in their jurisdiction.

The Principles are considered to be an important first stage in the facilitation and encouragement of international regulatory co-operation.

GLOSSARY OF TERMS

In the Principles and the Explanatory Memorandum the following terms are used with the following meanings:

Administrator	a person, which may or may not be the operator, who carries out all or part of the general administration of a CIS.
Advertising	any activity or notice (electronically communicated or otherwise) which publicly calls or draws attention to a collective investment scheme.
CIS	an open end collective investment scheme that issues redeemable units and invests primarily in transferable securities or money market instruments. For the purposes of these Principles, it excludes schemes investing in property/real estate, mortgages or venture capital.
Custodian	includes a trustee or depositary but not a sub custodian.
Delegate	means a third party engaged by the operator of a collective investment scheme to carry out certain tasks for the operator of the CIS, but does not include the custodian of the CIS.
Investment Manager	a person, which may or may not be the operator, who provides investment advice for the CIS.
Law	means the law of a member country and includes any rules, codes or regulations adopted under that law or imposed under the power of the regulatory authority.
Money market instruments	transferable securities that are usually traded on a money market, which the regulatory authority agrees are liquid assets and the value of which may be precisely determined at any time according to a permanent valuation methodology.
Operator	means the legal entity that has overall responsibility for management and performance of the functions of the CIS, which may include investment advice and operational services.

GLOSSARY OF TERMS

Prospectus	a formal written offer document offering units or shares in a collective investment scheme.
Purchase	when applying to units or shares, is the purchase of new units or shares, or existing units or shares, by an investor from the CIS or the operator.
Redemption	when applying to units or shares, is the sale of units either directly or indirectly by an investor to the CIS or the operator.
Regulated market	a market that is supervised by a public body in charge of defining its organisation and functioning rules, its operating and access conditions as well as contract specification and issuing conditions.
Regulatory authority	may mean either a single statutory or government authority or a combination of authorities that derive power from a single statutory or government authority.
Scheme rules	rules that govern the operation a collective investment scheme as laid down in the constituting documents of the CIS and, in the case of an investment company, includes matters referred to in the investment company's instruments of incorporation, by-laws and any standing resolutions
Transferable securities	any stocks, shares or other instruments which provide direct or indirect access to the equity capital of an issuer, or which provide a general debt right on its assets.
UCITS	are undertakings for collective investment in transferable securities as recognised in the EC Directive 85/611.
Umbrella funds	CIS that offer access to separate portfolios or sub funds covering different types of investment and represented by different classes of units with different issue and redemption prices.
Unit	refers to the proportionate holding that an investor has in a collective investment scheme and any reference to a unit shall include a share in an investment company.

1. LEGAL FORM AND STRUCTURE

The regulatory regime should have requirements as to the legal form and structure of CIS which provide certainty to investors in assessing their interest in a CIS and enable the pool of investors' funds to be distinguished from the assets of other entities. This may be achieved either through the use of the corporate form, a trust arrangement or other structure recognised under the law of the home jurisdiction as an acceptable form of collective investment scheme. The regime must place limits on or regulate the use of different types of securities which have differing claims on the assets of a CIS.

1.1 Umbrella Funds

1.1.1 The regulatory regime should require that the different sub-funds of an umbrella fund together exclusively comprise a single legal form with a common generic denomination and set of constituting documents. The law or the CIS rules should further make clear the nature of the relationship between the sub-funds especially the liability of one sub-fund for the liability of another sub-fund.

1.1.2 The regulatory regime applicable to individual CIS should apply equally to all sub-funds of an umbrella fund.

2. CUSTODIAN, DEPOSITARY OR TRUSTEE

The regulatory regime must seek to protect the physical and legal integrity of the assets of a CIS by separation of the assets from the assets of management, its related entities and other schemes, as well as from the assets of the custodian itself.

2.1 Appointment of Custodian

A custodian must be appointed to hold the assets or be in a position to ensure their safekeeping. The liability of a custodian for any losses suffered by the investors as a result of its unjustifiable failure to perform its obligations or its improper performance of them cannot be affected by the fact that it has entrusted to a third party all or some of the assets in its safekeeping.

2.2 Financial and Other Resources of the Custodian

The regulatory regime must impose qualifying requirements on custodians in relation to their financial and other resources, which either rely on the status of the custodian (for example, as a bank) or its ability to carry out the tasks required as judged by the regulatory authority under an individual approval regime.

2.3 Independence

A custodian should be functionally independent of the operator of a CIS and must always act in the best interests of investors.

3. ELIGIBILITY TO ACT AS AN OPERATOR

The regulatory regime should impose standards of conduct and minimum eligibility standards that require approval by the regulatory authority prior to commencement of marketing of a CIS. The degree of restrictions imposed on eligibility will be likely to vary according to the overall context of collective investment regulation, including the extent of ongoing regulation of CIS transactions and the existence of independent monitoring systems. To the extent that a regulatory regime imposes specific requirements, they should include the following.

3.1 Honesty and Fairness

An operator should observe high standards of integrity and fair dealing while acting in the best interest of a CIS. High standards of market conduct should be maintained. In addition to its investment responsibilities, the operator should also ensure that the assets of a CIS are adequately protected and segregated.

3.2 Capability

An operator should have sufficient human and technical resources to ensure that it is capable of carrying out the necessary functions of fund management.

3.3 Capital Adequacy

An operator should at all times maintain adequate financial resources to meet its investment business commitments and to withstand the risks to which its business is subject.

3.4 Diligence and Effectiveness.

An operator should act with due skill, care and diligence and employ effectively the resources and procedures which are needed for the proper performance of the schemes. An operator must organise and control its internal affairs in a responsible manner, with proper records and adequate arrangements for ensuring that employees are suitable, adequately trained and properly supervised. There should be well defined procedures in place to ensure compliance with regulations and all operators should deal with regulators in an open and co-operative manner.

3.5 Operator Specific Powers and Duties

An operator has a duty to make decisions as to the investment portfolio structure and administrative procedures of the CIS so as to secure its objectives. The operator must not exceed the powers conferred on it by the CIS's constituting documents or particulars.

3.6 Compliance

Operators and schemes must meet strictly defined standards as set by the regulatory authority, for both initial approval and continuing operation.

4. DELEGATION

The regulatory regime should ensure that the level of protection afforded to investors in CIS is maintained at all times. Where the management of CIS activities is provided externally to the operational management of the CIS through the engagement of third parties (delegates) to carry out certain tasks for the operator, the Principles which govern eligibility and conduct of the operator should also apply to such delegates. The following subprinciples apply to those jurisdictions that provide for external management.

4.1. Responsibility

An operator should take responsibility for the actions or omissions, as though they were its own, of any person to whom it delegates any part of the provision of services to a CIS.

4.2 Ongoing Monitoring

An operator should ensure that procedures are in place, designed to monitor the behaviour of delegates.

4.3 The Delegate

An operator must be able to show that a delegate is and remains competent to undertake the function in question. The operator must have a sufficiently detailed knowledge of the operating procedures of a delegate to be able to meet its regulatory responsibilities in a full and thorough manner.

4.4 Ongoing Co-operation

An operator should provide all reasonable means to permit a delegate to fulfil its obligations and should ensure that the contractual relationship between the operator and its delegate is unambiguous.

4.5 Level Playing Field

The use of delegates should not, in any way, diminish the effectiveness of the primary regulation of a CIS. The regulation of the business undertaken by a delegate should embody similar Principles of regulation to those relating to the regulation of schemes generally.

4.6 Compliance

A delegate should comply with all regulatory requirements applicable to the conduct of its business activities.

5. SUPERVISION

The regulatory regime must provide for a regulatory authority to take overall responsibility for the supervision of CIS authorised within its jurisdiction.

5.1 Registration and Authorisation

A CIS must be registered with or authorised by the regulatory authority prior to commencement of marketing of its units. That process may take the form of document filing, CIS registration or approval of the parties to the CIS (such as the operator and custodian) as appropriate to the overall regulatory system.

5.2 Inspections and Investigations

The regulatory authority should have the means to investigate conduct relating to CIS, including the power to conduct on-site inspections. These inspections may be carried out by the authority itself or its delegate (which may be the CIS's auditor).

5.3 Powers of the Regulatory Authority

The regulatory authority should have adequate powers to protect investors' interests, including but not limited to revoking an operator's licence, freezing CIS assets or the operator's assets, taking action to withdraw the CIS's authorisation or stop the use of a prospectus, instituting administrative or civil proceedings, and recommending criminal action where appropriate.

5.4 Third Party Supervision

The regulatory regime may provide for an independent third party or parties (in addition to the regulatory authority) to supervise the activities of the operator and any other parties involved in CIS activities.

6. CONFLICTS OF INTEREST

The regulatory regime should recognise that an operator of a CIS may have interests that if exercised without restraint would conflict in a material way with the interests of investors. Regulatory authorities should respond to this risk by ensuring that a regime provides for the exercise of management responsibilities with full regard to the best interests of investors. Such a regime may be general in nature, relying on the concept of "fiduciary responsibility" as interpreted domestically. Equally the establishment of detailed regulations designed to monitor potential conflicts between operator and investors is recognised as an acceptable regulatory method.

6.1 Possible Conflict of Interest Situations

Whether the concept of overall fiduciary responsibility is utilised, or provisions exist for detailed rules to monitor potential conflicts, a regulatory regime must be capable of dealing with certain situations which may give rise to conflicts of interest. They include (but may not be limited to):

(a) principal transactions between a CIS and its affiliates (including affiliates of the operator and custodian);

(b) transactions where a CIS and its affiliates jointly participate;

(c) soft commissions;

(d) lending or borrowing to or from affiliates;

(e) purchase of affiliate's securities;

(f) purchase of securities underwritten by affiliates;

(g) use of affiliated brokers; and

(h) employees' transactions for their own account

6.2 General Duties & Obligations

Possible conflict of interest situations may be addressed by the following:

(a) the duty of an operator to act in best interests of investors; and

(b) the power of the regulatory authority to impose sanctions for self-dealing, such as revoking the operator's licence, taking action to withdraw a CIS's authorisation or stop the use of a CIS's prospectus, freezing the assets of the operator, instituting administrative or civil proceedings, and recommending criminal action where appropriate.

6.3 Specific Regulatory Response

In addition to general duties and obligations, the means available to control conflict of interest situations (to the extent that they may arise within the regulatory framework of a particular jurisdiction) include all or a combination of some of the following:

(a) direct prohibition under the law;

(b) a precise code of business conduct either established by the regulatory authority, or a code established by a practitioner's organisation, which is approved and enforced by the regulatory authority;

(c) review and/or approval of certain transactions and activities by the regulatory authority;

(d) surveillance of operators by the regulatory authority;

(e) disclosure by the operator;

(f) record keeping by the operator;

(g) limitation of the activities of the operator; or

(h) independent review by a third party.

7. ASSET VALUATION & PRICING

The regulatory regime must provide a system for valuation of CIS assets, pricing of interests and procedures for entry to and exit from a collective investment which are fair to existing investors as well as to investors seeking to purchase or redeem interests. It is a fundamental principle that the price of interests in a CIS be calculated according to the net asset value of the CIS which must be determined on a regular basis in accordance with accepted accounting practices used on a consistent basis.

7.1 Valuations

7.1.1 Assets of the CIS must be valued according to their market price unless otherwise permitted by Law in particular circumstances. "Market price" means the price at which significant transactions have recently been concluded and disclosed to the market, or the best price available from a market maker. Should the market price not be available for any reason, the asset price should be calculated in good faith according to a permanent and reliable valuation procedure approved by the regulatory authority.

7.1.2 The net asset value per unit must be calculated in accordance with applicable accounting standards by dividing a CIS's assets less its liabilities by the number of units.

7.1.3 The net asset value per unit should be published at the operator's or at the custodian's offices or through the appropriate media.

7.1.4 The rules for asset valuation and for calculating the price of units must be laid down in the law or a CIS's rules or its public disclosure documents.

7.1.5 Information on the system for pricing, valuation and associated procedures must be made available to investors on requests.

7.2 Purchasing and Redemption of Units

7.2.1 A CIS must redeem its units at the request of any investor, in a manner and frequency laid down in the law or the CIS rules.

7.2.2 Redemption of units may only be suspended on a temporary basis. Any such suspension must be in accordance with the procedures provided for by the law or the CIS rules and must be in the interests of investors. A CIS must inform the regulatory authority of a suspension. In accordance with the laws of its jurisdiction, a regulatory authority may permit a CIS to suspend the right of redemption for the protection of investors.

7.2.3 Purchase of units may be done in cash, or in certain circumstances an investor may be allowed to use securities to purchase units. Redemption of units may be paid in cash, except when the CIS is liquidated and this possibility has been disclosed in the prospectus, or in certain circumstances when redemption may be by way of securities.

7.2.4 Purchase and redemption orders are to be settled as soon as possible, in accordance with the law, the CIS rules and the prospectus.

7.3 Unit Pricing

7.3.1 A CIS must calculate the purchase and redemption price of its units on a regular basis in accordance with the law and the CIS rules.

7.3.2 Purchase and redemption orders must be executed at the net asset value calculation price as defined in *Principle 7.1.2,* excluding any subscription or redemption fees disclosed in the prospectus. The amount received by the CIS on the issue of its securities must equal the net asset value calculation price as defined in Principle 7.1.2. Any redemption fees disclosed in the prospectus may be deducted from the net asset value calculation price otherwise payable to the investor.

7.3.3 Any purchase or redemption fee applicable to units in a CIS (as well as any management fee) must be clearly indicated in the CIS rules or the prospectus, and actual rates disclosed in the prospectus.

7.3.4 The distribution or reinvestment of the income of a CIS must be effected in accordance with the law and the CIS rules.

8. INVESTMENT & BORROWING LIMITATIONS

There should be investment restrictions, portfolio diversification and borrowing limitations that address the investment goals, the risk profile and the degree of liquidity required for a CIS to meet redemption in all market conditions. The need for liquidity typically contemplates a CIS investing primarily in transferable securities, money market instruments and derivatives incidental to the management of a securities portfolio.

8.1 Investments

Limitations imposed on CIS should indicate the extent of investment inter alia in the following:

(a) transferable securities not listed on a regulated market;

(b) transferable securities issued by the same issuer;

(c) derivative instruments; and

(d) other CIS.

8.2 Borrowing

Limitations imposed on CIS should also prescribe the extent of borrowing permitted, other than on a temporary basis, and the extent to which securities lending transactions may be entered into by the CIS.

9. INVESTOR RIGHTS

The regulatory regime should provide investors with certain rights in relation to a CIS, which are appropriate to the overall context of CIS regulation. A fundamental right of an investor in a CIS is the right to withdraw funds from the CIS within a reasonable period. The regime should also enable investors to participate in significant decisions concerning the CIS to the extent applicable under the structure of the CIS, or for the regulatory authority or another third party to have the capacity to act in the interests of investors.

9.1 Redemption Conditions

9.1.1. At the outset of the participation investors in a CIS must be fully informed through the prospectus of the charging of redemption and management fees.

9.1.2 Units of CIS must be repurchased or redeemed at the request of any unit holder, in a manner which does not give an unfair advantage to one investor in the CIS over any other investor. The regulatory regime should ensure that investor rights are maintained in the event of a major change in the activities of the CIS.

9.2 Access To Remedies

In addition to the normal access to legal procedures in the courts, investors should be able to refer matters to the regulatory authority for consideration. The regulatory authority must have proper powers of investigation, means to review investment managers and should have adequate powers (as noted in Principle 5.3) to enforce its decisions on the operator and on the custodian in order to protect investor's interests.

9.3 Investment Companies Only - Shareholder Powers

When a CIS is an investment company, investors should have the ability to participate in the affairs of the company through the exercise of a right to vote at periodic or special meetings of the shareholders.

10. MARKETING & DISCLOSURE

The regulatory regime must impose a disclosure requirement to ensure that there is full, accurate and timely disclosure to prospective investors providing all the information necessary for an investor to make an informed investment decision in relation to a CIS. Financial data and other information relating to the management and operations of a CIS must be provided on a regular (annual or semi annual) basis for the benefit of existing and prospective investors in the CIS. These requirements must be monitored by the regulatory authority to ensure that information provided meets the standards required.

10.1 Prospectuses

10.1.1 There must be a prospectus which complies with the standards applicable in the home jurisdiction of a CIS. No additional documents may be used for marketing a CIS, except for permitted advertisements or other literature which comply with applicable requirements.

10.1.2 A CIS prospectus must include all material information which investors would reasonably require and reasonably expect to find to make an informed investment decision. A prospectus must not contain information that is false or misleading. A prospectus must be in one of the recognised languages of the country of circulation, although a CIS may also provide advertisements and prospectuses in additional languages.

10.1.3 To the extent applicable under the relevant regulatory regime, minimum contents that would be expected to be addressed in the offering documentation include (but are not limited to):

- the date of issue of the prospectus;
- information concerning the legal constitution of the CIS, the rights of investors in the CIS and any pending material legal proceedings involving the CIS;
- information on the operator and its principals;
- procedures for purchase, redemption, and pricing of units;
- relevant financial information concerning the CIS;
- information on the custodian;
- the investment policy of the CIS, indicating the markets and instruments in which investments are made;
- information on the risks involved in achieving investment objectives;
- the appointment of any external administrators or investment managers or advisers who have a significant and independent role in relation to the CIS;
- fees and charges relating to the CIS;

- the regulatory authority, auditors and other independent third parties and their responsibilities in relation to the CIS.

10.1.4 Prospective investors must be offered (free of charge) a copy of the prospectus before the completion of an application form or the conclusion of a contract to purchase units.

10.1.5 The prospectus distributed to investors must be kept up-to-date to take account of any material changes affecting the CIS. In addition, prospectuses must either be revised on a periodic basis (such as annually or semi annually), or be accompanied by the most recent annual report and any subsequent semi annual report. Any material changes to information in a prospectus must be notified to the regulatory authority and by amendment to the prospectus, if necessary.

10.1.6 Circulation of a CIS prospectus to prospective investors should be conditional on filing of the prospectus with the regulatory authority. The regulatory authority must have the power to review all CIS prospectuses and suitable arrangements should be made for the review of their content, although it is not necessary for every prospectus to be reviewed. The regulatory authority must have the power to enforce withdrawal of a prospectus or take action if it does not meet applicable standards. Such review or approval of a prospectus should not be taken as endorsement of a CIS or as a guarantee to investors.

10.2 Regular Reporting

10.2.1 A report must be prepared in respect of a CIS's activities either on an annual or semi annual basis. The report must be filed with the regulator and made freely available to investors. The annual report of the CIS must be reviewed by an independent third party.

10.2.2 The annual and semi annual (if any) reports must contain accounting information relevant to the CIS and a statement concerning the interests in the CIS that have been redeemed or repurchased over the relevant period. The accounts of a CIS included in these reports must be prepared in accordance with applicable accounting standards.

10.3 Advertising

10.3.1 Advertising must normally be undertaken after all the necessary authorisations have been granted to permit the CIS to market to the investing public. Advertising must not contain information which is false or misleading or presented in a manner which is deceptive.

10.3.2 Advertising (except where only the prices of authorised schemes are quoted) should refer to the prospectus applicable to the CIS. There must be nothing in advertising of a CIS which is inconsistent with the prospectus. The regulator must have the power to enforce withdrawal of advertising or take appropriate action against non compliance.

EXPLANATORY MEMORANDUM

This Explanatory Memorandum is intended as an aid to understanding the core Principles of regulating CIS which have been developed by IOSCO Working Group 5. The explanatory text provides a guide concerning the scope of each of the Principles and their interpretation. It also provides examples of how the range of regulatory systems reviewed give effect to the investor protection Principles.

The Explanatory Memorandum is not intended to provide a comprehensive guide to the regulatory systems of all jurisdictions considered by the Working Group; it provides an overview of the range of regulatory approaches and in some cases specific examples are used to illustrate their effect.

For more detailed information on the regulation in various member countries an International Comparative Analysis will be published later.

1. LEGAL FORM AND STRUCTURE

There is a wide range of legal forms and associated structural requirements imposed on CIS under the regulatory regimes of member countries. The lack of compatibility of these structures has contributed significantly to the barriers to CIS entering foreign jurisdictions and marketing internationally. This variability in legal form and structure seems to have resulted from the unique cultural and legal settings of each member country. The legal form and structure of CIS have also influenced the way in which individual jurisdictions address their regulatory responsibilities.

The Principles recognise that a number of structures can be utilised to achieve the same investor protection objectives; there is no single structure which is considered appropriate for effective regulation of CIS. For example, company structures are commonly used in the USA, as well as in several European jurisdictions. Contract and trust based structures are also established under legislation in many European jurisdictions including the United Kingdom, as well as in Hong Kong, Japan, Canada and Australia. In a smaller number of jurisdictions, partnership and other structures may be used to establish CIS.

The main investor protection issues arising from the adoption of a particular structure are reflected in the Principles. These are that the structure should ensure that the assets of the CIS are clearly separated from other assets and that it should not create an unfair disadvantage for investors, such as might arise from the issuing of separate classes of interests.

Umbrella funds have been addressed in this Principle because of the particular regulatory issues that they give rise to. While the Principles refer to umbrella funds as comprising a single legal form, in some countries sub funds are recognised as separate legal entities for tax purposes. In the U.S. such funds are called "series funds", although they are generally treated as separate investment companies, and therefore do not raise many of the issues presented by umbrella funds.

The relationship between sub funds of umbrella funds and their assets and liabilities is an important investor protection issue. While member countries agree that it is best for investors that the assets and liabilities of sub funds always remain separate, it is recognised that there are differences in the legal position in those jurisdictions where umbrella funds exist. While in some jurisdictions, the liabilities contracted by one sub-fund cannot be limited to that sub-fund's assets, unless a contrary agreement with creditors has been made, in others there may be complete segregation of liabilities. Furthermore, in some jurisdictions, such as Australia, the exact legal position under the common law of trusts is not clear.

Consequently the key Principle in relation to umbrella funds is that, where there is not complete segregation of liabilities, the relationships between sub funds and their effect on investors are clearly disclosed, in particular the potential risks faced by investors depending on the segregation of liabilities. Although not required in all jurisdictions, there may also be a common administrator, operator, custodian and auditor of each sub fund of an umbrella fund.

2. CUSTODIAN, DEPOSITARY OR TRUSTEE

The requirement for separation of assets (usually by an independent custodian, trustee or depositary) is a feature common to all regulatory regimes. The primary role of the custodian is to hold the assets of the CIS in safe custody and to keep them separate from any other assets, in particular the assets of management. In some jurisdictions additional functions and duties are carried out by the custodian.

Appointment of Custodian

A custodian is appointed to be responsible for the safekeeping of CIS assets and is held accountable for those assets even though it may entrust the physical deposit of all or part of the assets to a third party. For example, in most jurisdictions the appointment of a sub custodian does not remove the ultimate responsibility of the appointed custodian.

An alternative to the appointment of a formal custodian, but which meets the objective of separation of assets, is the concept of "self custody" as it operates in the USA under the Investment Company Act and also in Canada. Under these arrangements a CIS may maintain custody or otherwise have access to CIS assets if certain additional protective conditions are met. It requires the assets to be deposited in the safekeeping of, or a vault maintained by, a bank or other company whose functions and physical facilities are supervised by federal or state authorities. In the United States these arrangements must be examined by an independent public accountant three times each year.

In Canada, the custodian of a CIS is often different from the trustee who carries out additional responsibilities.

Financial and Other Resources of the Custodian

Because of the importance of the custodian's role in protecting the assets of investors, all regulatory regimes impose certain minimum standards as to who may qualify as a custodian. In some jurisdictions a custodian may be required to be a bank and the regulatory authority relies on its approval as a bank to satisfy itself regarding the suitability of the custodian; in others, the regulatory authority may individually review and approve custodians for their ability (including financial and other resources) to properly carry out its functions. The latter is more likely to be the approach where the custodian fulfils additional responsibilities.

Independence

The independence of the custodian is considered critical to meeting its obligations. In many cases this means that a custodian must be legally independent of and totally unconnected with the operator of a collective investment scheme.

The concept of "independence" varies between jurisdictions, with some insisting upon there being no share holding relationship with the operator of a collective investment scheme, while others allow cross share holdings between the operator and custodian. Instead of restricting share holding relationships, some regulatory systems achieve the required degree of independence by the establishment of a separate corporate structure for the custodian, an independent board and separate lines of reporting to the management of the custodian.

In terms of performance of custodial functions, all regimes seek to ensure that the custodian is independent in the way it performs its obligations. In the Principles this is referred to as "functional independence", so as to distinguish it from absolute, structural independence. "Functional independence" may be achieved in a variety of ways (as described) provided each is appropriate to the broader regulatory framework.

The primary responsibility of a custodian is to ensure safekeeping of CIS assets. In some jurisdictions custodians are fiduciaries under the law and, as such, have direct responsibilities to investors. In other cases, such as the USA, the custodian's responsibilities are under a contract with the operator.

Additional Supervisory Responsibilities

Under some regulatory systems the custodian has additional supervisory responsibilities, although the extent of these responsibilities varies. They include supervision of the purchase and redemption of units in the CIS (including price calculation and settlement), review of the allocation of income and expenses, valuation of CIS assets, the keeping of proper accounts and general oversight of compliance with applicable laws and CIS rules.

While these additional supervisory responsibilities are key features of many regulatory systems, it is not essential that the supervisory role be carried out by the custodian. Instead, this supervision may be carried out by other third parties, such as auditors as is appropriate to the overall framework of regulation in individual jurisdictions. In the USA, for example, while not necessarily having the same role as a supervisory custodian an independent board of directors of an investment company supervises the activities of the operator.

3. ELIGIBILITY TO ACT AS AN OPERATOR

There is a wide range of regulatory systems and a variety of mechanisms for ensuring the suitability and proficiency of CIS operators. The Glossary of Terms defines an operator of a collective investment scheme.

In all jurisdictions operators of CIS are subject to authorisation either prior to, or as part of, authorisation of the CIS. "Authorisation" in this context may mean that an approval process is instituted by the regulatory authority (which assesses the suitability of the operator), or it may simply mean that the authority requires registration of the operator in order for the CIS to market its securities.

In some jurisdictions both the operator and the CIS itself must be registered with the regulators. In the US, for example, CIS are generally operated under an investment company structure (with its own board of directors) and the operator is a separate entity (usually called the investment manager) which is under contract to the investment company. The result is that the operator is licensed as an investment adviser and the CIS as an investment company.

This Principle recognises that eligibility requirements imposed as part of this authorisation process will vary according to the overall context of regulation, in particular where other factors effectively monitor operator conduct. In many European jurisdictions, the regulatory authority reviews the suitability of a CIS manager before authorisation. However, such a detailed review at the point of entry may not be required in the context of a rigorous inspections program and where there is prescriptive regulation of transactions undertaken by the operator.

Under the US system as described, the focus is not upon entry requirements for investment advisers (operators) or investment companies but instead upon prohibitions and other provisions designed to maintain standards of operator conduct on an ongoing basis. In this context, the imposition of substantive eligibility requirements is not necessary.

Specific Suitability Criteria and Standards of Conduct

The management eligibility sub principles identify specific criteria for the standard and conduct generally required of CIS operators. As noted in the Principles, these will not apply in jurisdictions where no substantive eligibility requirements are imposed at the point of entry. They nevertheless reflect the key attributes of operators and the objectives of those regulatory systems that use specific criteria applicable to CIS, at the point of authorisation and as part of a monitoring program.

A range of suitability criteria are imposed by regulatory systems on CIS operators including (but not limited to) the following:

- minimum net capital;
- sufficient human and technical resources;
- "fit and proper" test;
- educational requirements.

In the case of minimum capital requirements, many operators of CIS are subject to specific minimum amounts (such as HK$1 m in Hong Kong, DM5M in Germany) and in many other there is a general requirement to show capital adequacy.

In drafting the Principles, it is acknowledged that not all of these requirements will necessarily be set out in the laws of member countries; instead the Principles express objectives which should be embodied in the overall regulatory framework.

4. DELEGATION

CIS operators often engage third party investment managers or administrators to whom some or all of the functions and duties of the operator (but not overall responsibility) may be delegated. This Principle is concerned with the maintenance of investor protection in the event that delegation occurs.

Although sometimes described as "external management", this situation is different from the concept of "external management" which exists in the USA under the Investment Company Act. In the USA, CIS are legal entities operated by their officers subject to the oversight of a board of directors or trustees. Typically, US investment companies enter into agreements with parties for the provision of all necessary services including operational management and advice. Thus US funds generally do not contemplate delegation of investment authority from a manager to a third party investment adviser. In that regard many of the requirements of this Principle will not apply in the context of the US regulatory system.

There are other jurisdictions, such as Mexico, where delegation of functions by the operator is not permitted.

It is acknowledged that there are limits to the direct control that regulators have over delegates of CIS operators in the current regulatory framework. The Principles recognise these limits and focus on the effect that the use of delegates has on the protection of investors in a collective investment scheme. In some member countries specific approval is required for the use of delegates, while in others there is only a requirement to disclose material information concerning delegates. Where the delegate is an investment manager, generally the same rules will apply to the conduct of its business as an investment manager.

The aim of the Principle is to ensure that a CIS operator has primary and overall responsibility for the proper management of the CIS, and that the operator's accountability is not diminished by the appointment of delegates. Because of the limits on direct regulation of delegates, the Principles are concerned mostly with the ability of the operator to ensure that the functions of the delegate are being performed adequately. Another key role is for the Operator to monitor the delegate's performance and in this regard the means of monitoring will vary according to the overall regulatory framework.

Under the US system, the board of directors must ensure that procedures are in place designed to monitor the behaviour of the investment manager (also called an adviser). That manager has a fiduciary duty with respect to and must always act in the best interests of the fund. CIS may also enter into a separate contract with a sub adviser to manage some or all of the CIS's portfolio. Like the manager any sub adviser has a fiduciary relationship to the CIS and is liable for misconduct or breach of its fiduciary duties. A manager must reasonably supervise the activities of persons acting on its behalf and may remain responsible for the conduct of a sub adviser, depending on the facts and circumstances in each case.

5. SUPERVISION

The regulator's responsibilities in supervising the activities of CIS does not vary greatly, under the law of member countries. Analysis of different regulatory systems indicates that the role of the regulator is paramount and that it holds ultimate regulatory responsibility for CIS. This is reflected in the Principles. The manner in which individual regulatory authorities carry out their responsibilities does, however, vary according to the overall regulatory framework.

Key aspects of a regulator's role as reflected in the Principles are:

- registrations and authorisation;
- inspections and investigations; and
- enforcement powers.

It is recognised that in carrying out their responsibilities regulators may place a different emphasis upon their various powers and activities, and this is something that is likely to change over time depending on the policies of the various regulatory authorities. The role and activities of regulatory authorities is a matter for more detailed consideration by the Working Group in relation to international co-operation issues.

Registration and Authorisation

The activities of member countries in the area of "registration" ranges from the requirement for document filing to undertaking a detailed review of CIS documentation for compliance with the applicable law. The nature of documents lodged may include constituting documents, fund rules, prospectuses and so on. The common element among the various systems is that the regulator has a role in the process of CIS entering the market for the first time, although the level of active involvement of the regulatory authority varies from one jurisdiction to another. In some cases this will depend on the degree of prescription in the applicable law. Another common element is that regulatory authorities, even those that undertake a detailed review prior to CIS approval, do not endorse CIS nor guarantee their performance.

Inspections and Investigations

A further key Principle relating to supervision is the power of the regulatory authority to conduct inspections of CIS and investigations of their activities. Member countries may give effect to their inspection responsibilities in a variety of ways. For example, some aspects of inspections may be delegated to a third party (eg. an auditor) even though the regulatory authority has the power to conduct its own inspection. This is considered to provide an appropriate level of investor protection, provided the regulatory authority maintains overriding control and responsibility for CIS supervision.

Powers of the Regulatory Authority

It is fundamental that a regulatory authority have the powers to take action to enforce the obligations relevant to CIS. This Principle recognises that the nature of enforcement powers and penalties will vary from one jurisdiction to another, and that there are a variety of means to achieve adequate enforcement. The Principles identify the range of powers which might be available to enforce CIS requirements although they may not be exhaustive. The Principles do not imply that an individual regulatory authority must take action in any particular circumstances.

Third Party Supervision

As indicated previously, some systems rely on a third party (such as a custodian or auditor) to carry out some of these supervisory functions. While the regulatory authorities of some member countries rely on the role of third party supervisors, this does not make the regulator's role any less important. Examples of third party supervisors include trustees (with responsibilities additional to that of custodian), auditors, as well as independent directors on the board of an investment company (see Principle 2).

6. CONFLICTS OF INTEREST

There are wide ranging approaches by member countries to regulation of conflicts of interest. In all regulatory systems there is an overriding responsibility for CIS to be managed in the best interests of investors. This duty is variously expressed as

- acting exclusively in the interests of investors with the "diligence of an orderly business man";
- the duty to exercise good faith in the interest of investors when giving directions relating to a CIS;
- exercising powers and duties honestly, in good faith and in the best interests of the CIS;
- the duty to act for the sole benefit of the CIS's subscribers.

In some jurisdictions the obligation of an operator to act in the best interests of investors is implicit in their role as a fiduciary under the applicable law, although it may also be an explicit requirement of CIS regulation.

In addition to this general duty of CIS operators, it is essential that all regulators have adequate powers of investigation and enforcement to ensure that where specific circumstances give rise to a conflict of interest the regulator may take appropriate action. These issues are addressed in Principle 5 regarding Supervision.

Beyond these broad principles, the approaches of member countries to conflict of interest situations varies quite significantly. The existence of a general obligation to act in the best interest of investors will often mean that a CIS operator must ensure that CIS transactions are at arms' length and on a commercial basis, that they achieve best execution for the interests of the CIS and that the operator act independently of any other affiliations.

As well as a general obligation, some jurisdictions have adopted a very prescriptive approach to regulation of conflicts of interest. For example, in the US there are also explicit provisions under the Investment Company Act that specify the areas in which conflict occurs and addresses precisely how they must be handled, in some cases requiring that certain transactions be approved in advance.

Other regulatory systems (such as those in Mexico, Australia and many of the European jurisdictions) rely largely on the general obligations to investors, combined with close supervision of activities by the regulatory authorities and other third party supervisors. Another example of how conflict of interest situations may be addressed is by prohibiting the operator of a CIS from carrying out activities other than operation of a CIS.

The aim of this Principle is to ensure that there are proper responses from the regulatory regime to the potential for conflicts of interest. The Principle identifies a number of transactions as examples of situations which raise potential conflict of interest issues It is acknowledged that the list of situations identified in the Principles may not be comprehensive of all potential conflict of interest situations, but they represent the main areas of concern.

The use of the words "capable of dealing with..." in Principle 6.1 reflects the fact that not all regulatory systems explicitly restrict or prohibit these transactions in their applicable law; it also recognises that the response of member countries to these situations may differ.

The Principles use the term "affiliates" in describing a number of potential conflict of interest situations. Broadly, the term refers to those parties who may be affiliated with a CIS, its operator or custodian, or other parties to the CIS's activities. In many jurisdictions, the term "affiliates" or "associates" has a very specific and complex definition and the Working Group has not attempted to provide an all encompassing definition; a comprehensive definition can only be provided in a context of an individual regulatory framework.

The range of responses utilised in a regulatory system to deal with these conflict situations will depend on the overall regulatory framework and whether structural requirements influence the likelihood of the potential conflicts becoming real. The range of possible responses is meant to show that a number of approaches to regulation may be acceptable, and to note that a system of regulation need not embody all such responses in order to be effective. In most cases, member countries employ a number of techniques (direct and indirect) to resolve conflict of interest situations.

7. ASSET VALUATION & PRICING

A fundamental principle of collective investment regulation is the ability of investors to withdraw their funds (liquidate their interest) within a reasonable period. The calculation of unit price and the valuation of CIS assets is an important part of any regulatory system because of the direct interest that investors have in the underlying assets of the CIS. The regularity and accuracy in valuing the underlying assets of a CIS is essential for fairness and accuracy to be achieved in the pricing of interests, for both investors seeking to liquidate their units as well as investors remaining in a fund. These general principles are reflected in the preamble to Principle 7.

The Principles for Valuations, Purchasing and Redemption of Units and Unit Pricing each provide a statement of how the broad Principle applies in the context of CIS within the scope of the Working Group's mandate (ie those investing in transferable securities). The Principles have been drafted so as to cover a range of approaches considered acceptable to achieve the broad objectives.

While many jurisdictions impose specific requirements under the law, there are others that do not embody these Principles in applicable laws. Instead the Principles may operate as rules of best practice and are often embodied in the rules of individual CIS. In some regulatory systems, changes to the system for asset valuation and pricing must be approved by investors.

Provided these Principles are reflected in the rules of a CIS, it is not considered necessary for the laws of member countries to include these detailed requirements for effective regulation to occur.

Valuations

A fundamental Principle of asset valuation and pricing of CIS units is that it is based on the net asset value of the total pool of assets under management according to the market value of those assets, or some other value which is representative of their market value.

Many regulatory systems such as the United Kingdom and USA, provide detailed rules for asset valuation and unit pricing which are consistent with the general Principles but which, at a detailed level, vary in their approach. For example, there is presently a system of dual pricing of assets (bid and offer) operating in the United Kingdom. In the USA and Canada, there is a requirement to price CIS units on a forward pricing basis, although again this may not be common to all regulatory systems. US regulation also permits the use of a non-market prices for certain types of money market instruments and allows their value to be determined at their amortised cost according to a procedure approved by the SEC.

The system for pricing of units is often specified by the law, but in many jurisdictions it may also be set out in the fund rules or the prospectus. In Mexico, the system for pricing units must be disclosed in the prospectus.

Purchasing and Redemption of Units

In relation to redemption requirements, some jurisdictions require CIS to pay out redemptions within a specified amount of time while others (such as Australia) simply require the obligation to be met within a "reasonable" period. This would be judged according to the relevant commercial standards and, in practice, the time frame for payment of redemptions is similar to other jurisdictions notwithstanding the absence of a direct legal obligation.

The Working group has not proposed any specific time periods during which pricing of units must occur or redemption requests met. Specific time limits or periods are arbitrary in nature and will vary according to historical and commercial settings. In many jurisdictions, it is recognised that pricing must occur at least twice a month, although some authorities permit CIS to reduce the frequency to once a month on condition that it does not prejudice the interests of investors. Other jurisdictions require more frequent pricing. In the U.S., for example, a CIS must stand ready to redeem an investor's units each business day. A CIS must make payment within 7 days of the tendering of units for redemption.

Another key issue addressed by the Principles in relation to the purchase and redemption of CIS units is fees. While the Principles require purchase or redemption fees to be disclosed in the CIS rules or the prospectus, and actual rates in the prospectus, it is noted that some CIS will disclose a range of fees applicable and also may offer a variety of ways to investors for those fees to be charged.

8. INVESTMENT & BORROWING LIMITATIONS

This Principle provides a statement as to the scope of the Working Group's mandate and the range of schemes to which the Principles should apply. This Principle identifies the range of investments that may be made by a CIS for it to be the subject of the CIS regulatory Principles. The types of investments which fall within this range are also defined in broad terms.

In some jurisdictions different categories of CIS exist, which, whilst they are promoted to the public, are intended to meet specific investment objectives through different means than those covered in Principle 8. These schemes may also be governed by regulatory regimes that depart in various respects from the other Principles. These types of schemes include those dedicated to investing in derivatives, property/real estate, mortgages and venture capital and are not included in the scope of the Working Group.

This Principle recognises that a key benefit of investing through a CIS is a level of diversification of investment not offered by investment directly in securities. The Principle also recognises that, although borrowing by a CIS in connection with its investments can be appropriate, excessive borrowing by a CIS can be potentially damaging to investors. To give effect to this Principle, it is not necessary that specific requirements as to investment and borrowing limitations be imposed under the applicable laws of member countries. Instead, they may be met by the commercial practices of CIS operators as reflected in the rules of schemes that they manage.

In most jurisdictions the primary purpose of investment and borrowing limitations is to ensure that a CIS has sufficient liquidity to meet redemption requests and to address the CIS's risk profile. A feature of regulation that is common to most jurisdictions is the requirement to disclose the investment policy of a CIS to incoming investors and to take certain action in the event that a fundamental change occurs. This is addressed by Principle 10.1.3.

At a more detailed level, the approach to investment and borrowing limitations varies from one member country to another, with some imposing no more than a general restriction which requires there to be sufficient liquidity to meet redemption requests. There are other examples, where regulatory systems operating under the EC Directive on UCITS impose detailed requirements relating to investment and borrowing limitations. In jurisdictions, such as Germany, foreign schemes are not subjected to the same investment restrictions as domestic schemes, but gain access to that market primarily on the basis of full disclosure.

Because many member countries impose specific investment and borrowing limitations on CIS, the Working Group recognises that certain countries that wish to permit cross border marketing want to present a model for investment and borrowing limitations which they believe will satisfy the requirements of most of those countries and will provide guidance to CIS wishing to market cross border in those countries. While many of those jurisdictions will not impose all these requirements, there may be others that impose more stringent requirements in some cases.

Investment and Borrowing Limitations Model

(Relevant definitions are contained in the Glossary of Terms)

8.1 Transferable Securities and MMI

8.1.1 A CIS must invest its assets primarily in transferable securities negotiated on a regulated market and money market instruments whose value can be precisely determined at any time. This includes securities and MMI which are listed or negotiated on a regulated market.

8.1.2 At least 90% of CIS net assets other than cash and bank deposits must be invested in transferable securities or MMI.

8.1.3 The investment of a CIS in transferable securities or MMI issued by the same issuer must not exceed 10% of total CIS net assets. This limit may be increased when securities are issued or guaranteed by government authorities or by public international bodies.

8.2 Derivatives

8.2.1 For the purpose of efficient portfolio management, a CIS may be permitted to use derivatives provided they relate to transferable securities. Such exposure as it arises should be fully covered.

8.2.2 Eligible derivatives instruments are limited to futures and option contracts, swaps on interest rates, and indexes (of interest rates or securities) that are negotiated on a regulated market ("market traded derivatives").

8.2.3 CIS may also be permitted to invest in derivative instruments which are negotiated "over the counter" provided that:

(a) transactions are arranged with a highly rated counterparty;

(b) the contract is standardised;

(c) there is a fair off-setting provision in this contract; and

(d) a market value is available at any time.

8.2.4 Transaction on currencies (cash and forward) may be arranged by a CIS for hedging purposes only ie, in order to protect the CIS against adverse fluctuations in the value of the currencies in which foreign assets or foreign liabilities are denominated.

8.3 Warrants

Only warrants that are related to transferable securities and that are negotiated on a regulated market are eligible .

8.4 Other CIS Shares or Units

8.4.1 Investment may only be made in units of open-ended schemes that meet the IOSCO Principles of regulation and those of the host regulatory authority and are authorised by a regulatory authority.

8.4.2 Investment in units of other open-end CIS must be limited to 10% of the assets of the CIS. Arrangements must be made to eliminate the duplication of management fees and other charges.

8.5 Borrowing and Lending Rules

8.5.1 A CIS is allowed to borrow up to 10% of its assets in securities or in cash provided that the transaction is made on a temporary basis.

8.5.2 A CIS is allowed to lend up to 10% of its assets in securities, excluding cash, provided that the transaction is made on a temporary basis. Loaned securities are taken into account in the Principles of risk-spreading rules.

8.6 Limitations On Repos

A CIS may be allowed in some jurisdictions to use repurchase agreements. This technique is usually defined as a financing arrangement, used primarily in government securities markets, whereby a holder sells securities and agrees to repurchase them at an agreed future date, at an agreed price. The underlying security should be clearly identified and such transactions should fall within the scope of risk containment rules imposed by the regulatory authority.

8.7 Cash And Bank Deposits

Investments in cash and bank deposits may be made only on an ancillary basis.

8.8 Limitation On Voting Rights

An investment company or management company acting on behalf of all the CIS it manages must not acquire shares carrying voting rights which would lead to a significant influence as determined by the host regulatory authority.

9. INVESTOR RIGHTS

All regimes recognise the central importance of investor rights. The nature and extent of rights that individual investors have in CIS varies among member countries according to the overall regulatory framework.

In large part, the difference in investor rights is attributable to the legal form and structure of CIS. In those regulatory systems where investors have few rights to participate in management, there is significant reliance on the right of investors to liquidate or withdraw their investment. In other jurisdictions, investors are able to participate in management by calling meetings of investors and by their ability to remove the operator. The Principles recognise the different approaches, in particular, providing for the rights which may be given to shareholders of investment companies.

The Principles recognise that in all CIS the rights of investors are primarily to be able to withdraw their funds with relative ease. A key part of this Principle is that investors be fully aware of their rights at the time they invest. For example, if there is a fundamental change in CIS management (eg its investment policy) then some jurisdictions provide investors with the opportunity to withdraw their funds without any disadvantage and on substantially the same terms as existed prior to the change. Other jurisdictions, such as France, address this situation differently and allow investors to redeem their investment without paying any redemption charges.

There is also substantial reliance on the regulatory authority to enforce investors' rights. For example, in those jurisdictions where there is no direct right on the part of investors to remove the operator, the regulatory authority has such a right. In these circumstances, it is important that a regulatory authority has adequate powers to take up investor concerns and enforce their rights.

It is recognised that investors in CIS which are structured as investment companies often have more direct rights of participation (as shareholders) compared to other CIS investors. In those jurisdictions where investors are given these rights, one of the primary means of participation is through a general meeting of investors which may occur on an annual basis or more commonly where there has been significant change. In Luxembourg, for example, meetings of investors are required to approve annual accounts, dividend payment plan, selection of auditors, amendment of the articles and more importantly the election of directors.

In Australia, Hong Kong and the UK (although not under an investment structure) there is provision for investor meetings to consider certain matters such as changes to CIS rules, to increase any fees or to terminate the CIS. Meetings for these purposes tend to occur on an irregular basis.

10. MARKETING & DISCLOSURE

All regulatory systems have mandatory disclosure requirements for both new and existing investors in CIS.

In relation to disclosure to new investors, all member countries require there to be a formal written offer document disclosing all relevant information. This is commonly called a prospectus, but may also include ancillary documentation such as annual or half yearly reports, statements of additional information, scheme rules and so on. The Principles refer to these collectively as "offering documentation" and it is noted that the disclosure obligations may be satisfied by using a combination of documents.

Prospectuses

The general disclosure standard applied under the law of member countries varies slightly from one country to another, but the fundamental Principles are similar: that the information provided is what an investor would reasonably require and that the information is not false or misleading. Some regimes also specify disclosure of prospects of a CIS, but it is not considered necessary to separately specify these matters under the general Principle.

The Principles recognise the importance of the prospectus being understandable by the investing public of the country of circulation. Hence it is considered that the prospectus should be in one of the recognised languages of the country of circulation. In most cases this would be the "official language" but in some countries, such as Hong Kong and Luxembourg, there may be a number of languages which are recognised. It is also permissible for the prospectus and other material (such as advertising) to be provided in other languages in addition to the recognised languages.

At a more detailed level, the approach of member countries to the content of disclosure documents varies, with many providing a list of matters that must be included and others providing no minimum content requirements at all. Some member countries require information to be provided in a certain format. The Principles set out some of the key information that member countries agree should, as a matter of practice, be included in a prospectus or in the "offering documentation" as a whole. The categories provided are not intended to be comprehensive, since there is ultimate reliance on the general standard of disclosure, or an obligation to provide such information as an investor would reasonably require. Furthermore, it is not envisaged that the matters listed will necessarily be specific requirements under the laws of member countries.

In relation to the currency of offer documentation, all member countries agree that it should be kept up to date. The means by which this is achieved varies from country to country. For example, in Australia, this means renewing the prospectus at least every 12 months and also being required to update the prospectus to take account of any material changes during that 12 month period. In other countries, the core prospectus document is updated as and when required and the accompanying annual and semi annual reports provide a regular financial update on the CIS.

The approach of regulatory authorities also varies in relation to the review of CIS prospectuses. In some cases, there is a detailed review of the prospectus before authorisation of a CIS; in others only a selective review is undertaken after the CIS has commenced marketing. This review might be undertaken by the relevant authorities or a co regulatory body. All of these approaches are considered appropriate in their jurisdictions to achieve effective regulation of CIS prospectuses.

Regular Reporting

Regular reporting to existing investors is a fundamental Principle of collective investment regulation. In all member countries, CIS are required to report on an annual basis and to make these reports available to investors in the CIS; some (but not all) require semi annual reports to be prepared. While these reports must always be available to investors, not all jurisdictions require them to be sent to investors.

In all countries, the financial statements must be prepared in accordance with the accounting standards applicable to CIS in the country of regulation. This means that in most cases if a CIS is marketed in a particular jurisdiction, it will need to strictly comply with the accounting standards of that jurisdiction, which may be different from its home jurisdiction. In most cases, part or all of the CIS annual report is reviewed by a third party, usually an auditor or certified public accountant in particular the financial statements.

Advertising

Member countries take a variety of approaches to advertising. In some cases, advertisements must be approved by the regulatory authorities; in others there are certain statutory requirements which must be met in order for advertisements to comply.

Because of these varying approaches the Principles do not specifically require that regulatory authorities authorise or approve advertising. Instead the Principles indicate that advertising of CIS should not be undertaken until "all the necessary authorisations have been granted to permit the CIS to market to the investing public". This means that if an advertisement is required to be authorised, it should not be used until authorised; alternatively if all that is required is for the CIS to be authorised or registered (in the broader sense) that such authorisation must have been given, before the advertising is used. The Principle does not mean that advertising must be directly authorised or approved.

The Principles in relation to advertising acknowledge that while reference to a prospectus is an important requirement, certain advertising, such as price quotation of CIS, will not necessarily make any reference to a prospectus and may not be required to do so. In some cases, this is a requirement of the law but in others it may be representative of industry best practice.