

**GUIDANCE NOTE**

**INCORRECT PRICING OF UNITS IN COLLECTIVE INVESTMENT SCHEMES -  
RECORDING AND REPORTING OF ERRORS – CORRECTION, REIMBURSEMENT  
OR PAYMENT OF COMPENSATION**

**January 2002**

# **INCORRECT PRICING OF UNITS IN COLLECTIVE INVESTMENT SCHEMES - RECORDING AND REPORTING OF ERRORS – CORRECTION, REIMBURSEMENT OR PAYMENT OF COMPENSATION**

## **Introduction**

The Financial Supervision Commission ('Commission') considers it appropriate to address some issues in relation to the incorrect pricing of units<sup>1</sup> in collective investment schemes that are authorised by the Commission or in schemes that are managed or administered by entities in the Isle of Man that are licensed by the Commission.

To date, it has been the practice of Isle of Man fund managers and administrators to follow the rules and guidance issued by the UK Investment Management Regulatory Organisation ('IMRO'). These rules and guidance relate to errors in the pricing of UK authorised collective investment schemes (i.e., open-ended investment companies and unit trusts). The Commission has endorsed the application of these principles in the Isle of Man.

Following its establishment, policy in relation to UK authorised collective investment schemes is now determined by the Financial Services Authority ('FSA') in the UK. In June 2001, the FSA produced the final text of its Collective Investment Schemes Sourcebook ('CIS Sourcebook') which followed from a consultation process on a draft document (CP62) which was published in August 2000. The CIS Sourcebook broadly imports the rules and guidance promulgated by IMRO.

It is expected that, in the Isle of Man, the Financial Supervision (Authorised Collective Investment Schemes) Regulations 1988 will be revised early in 2002. As the Isle of Man is a Designated Territory under Section 87 of the Financial Services Act 1986<sup>2</sup>, it is important that the Regulations and rules in respect of authorised schemes in the Isle of Man follow closely the equivalent requirements in the UK. For this reason, it is the Commission's policy in the collective investment schemes area to follow closely any guidance emanating from the FSA also.

Therefore, the guidance contained in the following sections of this paper follows closely the principles contained in the FSA CIS Sourcebook. Whilst this guidance is primarily designed for Isle of Man authorised schemes, the Commission would expect that Isle of Man licensed fund managers and administrators would apply the principles in a similar manner to schemes that are not authorised in the Isle of Man, in the interests of investors, the protection of their own reputations and that of the Isle of Man.

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<sup>1</sup>The term 'unit' (and, correspondingly, 'unitholder') has been used throughout this paper to indicate a unit in a unit trust or a share in an investment company.

<sup>2</sup> The equivalent provisions are contained in Section 270 of the Financial Services and Markets Act 2000.

The paper makes reference in some instances to judgements being made by the trustee of a scheme. It is recognised that in the case of some schemes that are not authorised in the Isle of Man that there may not be a trustee in place to make the necessary judgements. In such instances, the Commission would expect the manager or administrator to consult with an appropriately qualified independent third party (e.g., a custodian, lawyer or accountant) to assist in making these judgements, where the amounts are material.

### **Coverage of Guidance**

The Commission's guidance covers two issues:

- (i) the Recording and Reporting of instances of incorrect pricing; and
- (ii) the Reimbursement or Payment of Compensation due to incorrect pricing.

### **Recording and Reporting of instances of incorrect pricing**

#### ***(i) Recording and reporting by the licensed fund manager (or administrator)***

A licensed fund manager (or administrator) should record each instance where the fourth significant figure of a price of a unit is incorrect and, as soon as the error is discovered, report the fact to the trustee (where there is one) together with details of the action taken, or to be taken, to avoid repetition. Where there is no trustee, the manager or administrator should report to the Commission where the error is material as determined by the factors outlined in (ii) below.

#### ***(ii) Reporting by the trustee***

The trustee should report any instances of incorrect pricing of units to the Commission as soon it becomes aware of the error. However, notification should relate to instances which the trustee considers material only. Materiality should be determined by taking into account a number of factors including:

- (a) whether the licensed fund manager (or administrator) has in place adequate procedures and controls in determining prices of units and whether he has followed these procedures;
- (b) the significance of any breakdown in management controls or other checking procedures;
- (c) the significance of any failure of systems, including situations where inadequate back-up arrangements exist;
- (d) the duration of an error (the longer an error persists, the more likely that it will have a material effect on a price);
- (e) the level of compensation that would be due to unitholders; and
- (f) the licensed fund manager's (or administrator's) ability (or otherwise) to meet the payment of compensation in full.

A trustee should also report to the Commission immediately any instance of incorrect pricing where the error is greater than 0.5% of the price of a unit, where the trustee

believes that reimbursement or payment is inappropriate and should not be paid by the licensed fund manager (or administrator).

***(iii) Quarterly reporting to the Commission***

A trustee (or, where there is no requirement for a trustee, a licensed fund manager (or administrator)) must report to the Commission within one month of each quarter-end date the number of instances of incorrect pricing during the period. This should include (i) the number and size of errors greater than 0.5% of the price of a unit and (ii) the number and size of errors less than 0.5% of the price of a unit where the trustee did not consider the licensed fund manager's (or administrator's) systems and controls to be adequate. The format of the Report will be prescribed by the Commission.

**Reimbursement or Payment of Compensation due to incorrect pricing**

The Commission considers that there is a duty on the licensed fund manager (or administrator) to take action to reimburse affected unitholders, former unitholders, and the scheme itself, for certain instances of incorrect pricing. However, reimbursement or payment of compensation may not be required if it appears to the trustee (or the appropriately qualified third party) that the incorrect pricing is of 'minimal significance'. In determining whether an instance of incorrect pricing is of 'minimal significance', the trustee (or the appropriately qualified third party) may take into account

(a) the adequacy of the systems and controls which the licensed fund manager (or administrator) has in place in determining prices of units and the adequacy of pricing checks undertaken by the trustee; and

(b) whether the error in pricing of a unit is less than 0.5% of the correct price.

If the trustee (or the appropriately qualified third party) is satisfied that the systems and controls and the pricing checks in (a) are adequate and if the error is below the threshold in (b) then it may consider that the error is of 'minimal significance'. In all other circumstances the error would normally not be of 'minimal significance'. Nevertheless, should a trustee (or the appropriately qualified third party) consider that reimbursement or payment of compensation is inappropriate, it should report the matter to the Commission, together with its recommendations and justification.

In all cases where reimbursement or payment of compensation is required (as determined by the trustee or the appropriately qualified third party), amounts due to be reimbursed to unitholders in authorised or international schemes for individual sums under £10 will not, normally, need to be paid, although a licensed fund manager (or administrator) may pay such a sum, or may wish to make up smaller amounts to a higher figure (such as the £10 minimum).

As regards other schemes administered by licensed entities in the Isle of Man, for example Professional Investor Funds and Experienced Investor Funds, the Commission

does not wish to be prescriptive on *de minimis* compensation amounts, as each case would need to be considered on its own merits.

*The application of the above principles does not prejudice the legal right of any unitholder to claim compensation.*

Supervision Division  
Financial Supervision Commission  
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