

RBS Collective Investment Funds Limited

Derivatives Risk Management Policy

Compiled by: RBS Collective Investment Funds Limited
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Introduction

The Financial Conduct Authority (**the FCA**) requires under COLL 6.12 that:

1. (a) An *Authorised Fund Manager* (**AFM**) of a *UCITS scheme* must use a risk management process enabling it to monitor and measure at any time the risk of the *scheme's* positions and their contribution to the overall risk profile of the *scheme*

(b) In particular, an *AFM* of a *UCITS scheme* must not solely or mechanistically rely on credit ratings issued by credit rating agencies, for assessing the creditworthiness of the *scheme's* assets.
2. An AFM must regularly notify the following information to the *FCA* and at least on an annual basis:

(a) a true and fair view of the types of *derivatives* and forward transactions (Financial Derivative Instruments or **FDI**) to be used within the *scheme* together with their underlying risks and any relevant quantitative limits; and

(b) the methods for estimating risks in *derivative* and forward transactions.

This document sets out that process in respect of the Investment Companies with Variable Capital (**the ICVCs**) and their Funds (**the Funds**) that are managed by RBS Collective Investment Funds Limited (**RBSCIFL**), their AFM or Authorised Corporate Director (**ACD**).

The funds managed by RBSCIFL are detailed below:

RBS Investment Funds ICVC (IF ICVC):	Global Bond Fund
	Managed Defensive Fund
	Managed Equity Growth Fund
	Managed Growth Fund
	Managed Income Fund
	UK Equity Fund

RBS Stakeholder Investment Fund ICVC:	Stakeholder Investment Fund
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(SH ICVC)

In particular, this document addresses the following:

- Types of FDI and efficient portfolio management techniques used in the ICVCs, their commercial purpose and the associated risks (if any);
- Parties involved, their roles and responsibilities together with details of escalation processes;

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- Breach reporting and escalation (NB all breaches will be escalated immediately);
- Methodologies and controls in respect of position exposure, Global Exposure, leverage and counterparty exposure;
- Quantitative limits set; and
- Other issues of relevance

This document has been produced by RBS Collective Investment Funds Limited (**the Manager**) with appropriate input from other relevant parties – Coutts & Co (**the Investment Manager**), The Bank of New York Mellon (International) Limited (**the Depository**), The Bank of New York Mellon (International) Limited (**the Fund Accountant**) and RiskSystem (**the Risk Services Provider**).

The document has allowed for the role of the Risk Services Provider, who is expected to be appointed with effect from end July 2019. In the interim period, reporting was provided by the Risk team of the Investment Manager and reviewed by the Risk Management Committee.

The ICVCs are open-ended investment companies authorised pursuant to the European Communities Undertakings for Collective Investment in Transferable Securities Regulations 2011, as may be amended. They are regulated by the Financial Conduct Authority under their Collective Investment Schemes Sourcebook (**COLL**).

The IF ICVC has an umbrella structure, which may be comprised of different Funds with segregated liability between its Funds, to provide both individual and institutional investors with a choice of shares in different Funds. Each Fund may be differentiated by its specific investment objective, policy, or other specific features as described in the Prospectus. A separate pool of assets is maintained for each Fund and is invested in accordance with each Fund's respective investment objective. As the IF ICVC has segregated liability between its Funds, any liability incurred on behalf of, or attributable, to any Fund shall be discharged solely out of the assets of that Fund. Shares may be issued in relation to each Fund and may comprise of one or more classes of shares (see Appendix I).

The SH ICVC is comprised of a single Fund representing the entire company. Its investment objective, policy, and other specific features are described in the Prospectus.

This derivatives risk management process document (DRMP) describes the use of FDI by the Funds and sets out the risk management process to be employed by RBS Collective

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Investment Funds Limited (**the Manager**) as required by the Financial Conduct Authority (**the FCA**). RiskSystem (**the Risk Services Provider**) has been appointed by the Manager to perform the Permanent Risk Management Function in accordance with COLL. It describes the processes and systems in place which provide a risk management system for the Funds in the context of the usage of Financial Derivative Instruments (**FDI**) for Efficient Portfolio Management (**EPM**) and hedging purposes. The DRMP also sets out the structure of limits, guidelines and other parameters used to govern the Funds' use of FDI.

Should the policy of a Fund, and as a consequence, the risk profile thereof, change at a date in the future, then an amended or new DRMP will be reviewed and approved by the RBSCIFL Board and will be submitted to the FCA.

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1.1 Parties involved in Risk Management Process

The ICVCs have appointed RBS Collective Investment Funds Limited (**the Manager**) as their ACD. The Manager has appointed Coutts & Co (**the Investment Manager**) to act as investment manager for the Funds. The Manager has appointed The Bank of New York Mellon (International) Limited, (**the Fund Accountant**) as fund accountant and The Bank of New York Mellon (International) Limited (the Depositary) as Depositary.

1.1.1 Board of Directors of the Manager and Risk Function

The ICVCs have appointed RBS Collective Investment Funds Limited, a company incorporated in Scotland on 23 June 1969, as its Manager. The Manager is a wholly owned subsidiary of RBS Collective Investments Holdings Limited which in turn is a wholly owned subsidiary of RBS Asset Management Holdings and is ultimately owned by The Royal Bank of Scotland Group Plc, a company incorporated in Scotland.

The Manager is authorised and regulated by the FCA pursuant to COLL. Pursuant to a Management Agreement between the ICVCs and the Manager, the Manager is responsible for the ICVCs' day-to-day management and administration, and for the implementation of its investment policy. The Manager has delegated certain administrative duties to the Fund accountant.

The Board of Directors of the Manager (**the RBSCIFL Board**) is responsible for the risk management function of the Manager and for ensuring that an appropriate risk management process is in place and that it is functioning adequately.

Given the nature and scale of the Manager's operations and the delegation by it of certain functions, the RBSCIFL Board will rely on the day-to-day risk management functions of its service providers, subject to the ongoing monitoring under the High Level Controls Document. The RBSCIFL Board is satisfied that the service providers have appropriate safeguards against conflicts of interest to ensure the independent performance of the risk management function in accordance with the Regulations.

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The RBSCIFL Board will periodically review the risk management policy and procedures for the ICVCs, Manager and Funds. Accordingly, the Risk Services Provider is responsible for certain risk management functions as detailed below and in particular for ensuring that the risks involved in using FDI are managed, measured and monitored and will report to the RBSCIFL Board on a quarterly basis (see Section 4 – Reporting).

Should the policy of a Fund, and as a consequence, the risk profile thereof, change at a date in the future, then an amended or new DRMP will be reviewed and approved by the RBSCIFL Board and will be submitted to the FCA.

1.1.2 Investment Manager

The Manager has appointed Coutts & Co to act as the Investment Manager for the Funds.

Coutts & Co was established in 1692 and is authorised and regulated in the UK by the FCA in the conduct of its designated investment business.

The Investment Manager carries out the business of a wide range of banking and financial services including investment management. It is ultimately a wholly owned subsidiary of The Royal Bank of Scotland Group plc, a public limited company incorporated in Scotland and listed on the London Stock Exchange.

The Investment Manager is responsible for pre-trade compliance with each Fund's risk limit framework as determined by the RBSCIFL Board and in accordance with the Prospectuses and COLL. The Investment Manager will also be a recipient of reports from the Risk Services Provider including advice of any breaches to the limits.

The Investment Manager has a Portfolio & Risk Analytics team that provides support in respect of their investment decisions for the Funds.

1.1.3 Fund Accountant

The Bank of New York Mellon (International) Limited incorporated in England on 9 August 1996. The Fund Accountant is a wholly-owned indirect subsidiary of The Bank of New York Mellon Corporation. The Bank of New York Mellon Corporation

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is a global financial services company focused on helping clients manage and service their financial assets, operating in 36 countries and serving more than 100 markets. Pursuant to a Fund Accounting Agreement between the Manager and the Fund Accountant, the Fund Accountant is responsible for the Fund accounting of the ICVCs.

The duties and functions of the Fund Accountant include, inter alia, the calculation of the Net Asset Value, the provision of facilities for the registration of Shares, the keeping of all relevant records and accounts of the ICVCs and each Fund as may be required with respect to the obligations assumed by it pursuant to the Fund Accounting Agreement, producing, and assisting the auditors in relation to the audit of, the financial statements of the ICVCs and providing such other reports, accounts and documents as the Manager may from time to time request.

1.1.4 Depositary

The Fund has appointed The Bank of New York Mellon (International) Limited to act as the Depositary to the ICVCs. The Depositary is a private limited liability company incorporated in England on 9 August 1996. The Depositary is a wholly-owned indirect subsidiary of The Bank of New York Mellon Corporation.

The Depositary has fiduciary responsibility under COLL for independent monitoring of all investment limits, monitoring processes in respect of FDI, and independent oversight of the administration and pricing functions in respect of FDI.

The Depositary is responsible for independent investment restrictions monitoring and has certain oversight responsibilities relating to the administration of the Fund. The Depositary has responsibility under COLL in this regard and reports annually to the Shareholders of the ICVCs.

In order to satisfy this obligation the Depositary carries out an independent review on a monthly basis of the majority of investment, borrowing and efficient portfolio management restrictions as are contained in COLL and the Prospectuses. The services provided by the Depositary are additional to the DRMP employed by the Manager and Risk Services Provider.

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Any breach of investment, borrowing and efficient portfolio management restrictions identified by the Manager or the Investment Manager will be notified to the Depositary along with other breaches as part of the overall breach monitoring process.

Any breach of investment, borrowing and efficient portfolio management restrictions identified by the Depositary would be notified to the Manager upon identification. A report of any breaches of investment, borrowing and efficient portfolio management restrictions is reported quarterly to the Manager.

1.2 Policy on the level of expertise required by persons engaged in any part of the planned FDI activity

The Investment Manager ensures that all staff engaged in portfolio management, execution, or monitoring of FDI activities on behalf of the Fund have the appropriate experience and skills to ensure robust risk control for the Fund.

Typically these individuals will, at a minimum, have extensive practical expertise, often a university degree and/or other relevant professional qualification, and have several years' experience in handling similar types of FDI.

1.2.1 Fund Accountant

The Fund Accountant is authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority.

1.2.2 Depositary

The principal activity of the Depositary is to act as the depositary of the assets of collective investment schemes. The Depositary is authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority.

1.3 Details of all FDI to be used with a summary of their commercial purpose

The FDI detailed below are used for efficient portfolio management (**EPM**) and hedging purposes to gain exposure to markets in a cost efficient manner consistent with the maintenance of an appropriate level of risk within each Fund. FDI may also be used to hedge the currency and/or interest rate exposure of the assets of a Fund attributable to a particular Share Class. Variance swaps, volatility swaps and exotic types of options will not be used.

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FDI, EPM and Techniques

While the prudent use of FDI can be beneficial, FDI also involve risks different from, and in certain cases greater than, the risks presented by more traditional investments.

Subject to COLL and the Prospectuses, each Fund may utilise FDI including equivalent cash settled instruments dealt on a regulated market and/or OTC FDI. The permitted Regulated Markets are set out in the Prospectuses.

Techniques and FDI utilised for the purposes of EPM may only be used in accordance with the investment strategy of the relevant Fund. Any such technique or instrument should be reasonably believed by the Investment Manager to be economically appropriate to the EPM of the relevant Fund, i.e. the use of such a technique or instrument may only be undertaken for the purpose of one or more of the following:

- (a) a reduction in risk;
- (b) a reduction in cost; or
- (c) an increase in capital or income returns to a Fund with a level of risk which is consistent with the risk profile of the Fund.

The specific techniques and instruments to be utilised by each Fund are set below.

For the purpose of providing margin or collateral in respect of transactions in FDI, the Manager may transfer, mortgage, charge or encumber any assets or cash forming part of the relevant Fund.

The Investment Manager, on behalf of each Fund, may use investment techniques and instruments, including FDI, relating to transferable securities and other financial instruments as follows:

- futures contracts;
- forwards contracts;
- swap agreements;
- options;
- credit default swaps;

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total return swaps
interest rate swaps
structured products;
warrants;
convertible bonds.

The use of stocklending agreements , repurchase agreements and reverse repurchase agreements is not permitted.

1.3.1 Futures Contracts

A futures contract is a standardised contract made via a futures exchange to buy or sell an asset (a physical asset¹ or financial instrument) at a specified future time at a pre-determined price in the future. Futures contracts detail the quality and quantity of the underlying asset; they are standardised to facilitate trading on a futures exchange.

Positions in futures contracts may be closed out only on an exchange that provides a secondary market for such futures. Exchanges require that counterparties post margin to the exchange in order to open a position and may require further margin to be posted related to the actual, or potential increase in, market value of the underlying futures contract.

Futures contracts allow investors to hedge against market risk or gain exposure to the underlying market. Since these contracts are marked-to-market daily, investors can, by closing out their position, exit from their obligation to buy or sell the underlying assets prior to the contract's delivery date. Futures may also be used to equitize cash balances, both pending investment of a cash flow and with respect to fixed cash targets. Using futures to achieve a particular strategy instead of using the underlying or related security or index may result in lower transaction costs being incurred.

1.3.2 Forward Contracts

A forward contract is a non-standardised, negotiated, OTC contract between two parties to buy or sell an asset at a specified future time at a price agreed upon

¹ Futures on physical assets, such as commodities and precious metals, are not permitted.

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today. Forward contracts may be cash or physically settled between the parties and these contracts cannot be transferred.

A Fund may take or hedge currency exposure through the use of foreign exchange (FX) contracts such as currency forwards and currency swaps.

Some of the assets of the Fund may be held in currencies other than the base currency. Accordingly, the Fund may at the discretion of the Investment Manager also enter into such forward FX contracts to seek to hedge such currency exposures back into the base currency of the Fund.

1.3.3 Swaps

A standard swap is an agreement between two counterparties in which the cash flows from two assets are exchanged as they are received for a fixed time period, with the terms initially set so that the present value of the swap is zero. The Funds may enter into swaps both as independent profit opportunities and to hedge existing long positions. Swaps may extend over substantial periods of time, and typically call for the making of payments on a periodic basis.

Swaptions are contracts whereby one party receives a fee in return for agreeing to enter into a forward swap at a predetermined fixed rate if some contingency event occurs (normally where future rates are set in relation to a fixed benchmark).

Interest rate swaps involve the exchange by a fund with another party of their respective commitments to make or receive interest payments (e.g. an exchange of fixed rate payments for floating rate payments). On each payment date under an interest rate swap, the net payments owed by each party, and only the net amount, is paid by one party to the other.

Currency swaps are agreements between two parties to exchange future payments in one currency for payments in another currency. These agreements are used to transform the currency denomination of assets and liabilities. Unlike interest rate swaps, currency swaps must include an exchange of principal at maturity.

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1.3.4 Options

Put options are contracts that gives the buyer the right, but not the obligation, to sell to the seller of the contract, a specific quantity of a particular product or financial instrument at a specified price. Call options are contracts sold for a premium that gives the buyer the right, but not the obligation, to buy a specific quantity of a particular product or financial instrument at a specified price from the seller of the option. In return for granting the option the seller of the option collects a payment, or premium, from the buyer. Options may be cash or physically settled (e.g. by the delivery of another financial instrument or security).

The purpose behind the purchase of call options by a Fund is to provide exposure to increases in the market (e.g. with respect to temporary cash positions) or to hedge against an increase in the price of securities or other investments that a Fund intends to purchase. The purpose behind the purchase of put options by a Fund is to hedge against a decrease in the market generally or to hedge against the price of securities or other investments held by a Fund.

1.3.5 Credit Default Swaps

Under credit default swap (**CDS**) contracts, the purchaser of protection under the swap will make periodic payments to the seller of the CDS. In return the credit default protection seller will make a payment to the credit default protection buyer upon the occurrence of a specified credit event. A CDS can refer to a single issuer or asset, a basket of issuers or assets, each known as the reference entity or underlying asset.

A Fund may use CDS to acquire or reduce credit exposure to a particular issuer, asset or basket of assets. A Fund may also use CDS contracts to manage its credit exposures under which the Fund may be a buyer or, less likely, a seller of credit protection. Where a Fund is a seller of credit protection, this will add leverage to the fund to the extent that the margin required by the dealer was less than nominal exposure of the portion. Any leverage created this way would be included in the funds leverage calculation and be subject to the 100% maximum.

1.3.6 Total Return Swaps

A total return swap is an agreement in which one party makes payments based on a set rate, either fixed or variable, while the other party makes payments

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based on the return of an underlying asset, which includes both the income it generates and any capital gains.

1.3.7 Interest Rate Swaps

An interest rate swap is an agreement negotiated between two parties to exchange recognised interest rate cash flows, calculated on a notional amount, at specified dates during the life of the swap. The notional amount is used only to determine the payments under the swap and is not exchanged. The payment obligation of each party is calculated using a different interest rate, typically with one party paying a floating interest rate in return for receiving a fixed interest rate, either at regular intervals during the life of the swap or at the maturity of the swap. Interest rate swaps may be used to take short positions or to manage interest rate risk and duration exposure.

1.3.8 Structured Notes

A Fund may invest in freely transferable structured notes, which are debt instruments where the return is linked to the performance of a financial instrument or instruments, index, asset, stock, or basket of indices, assets or stocks provided that such financial instruments comply with the FCA's conditions and criteria for investments in such securities and are envisaged by the investment policy of the Fund. A Fund may use structured notes, such as equity linked notes, for investment purposes.

Where a Fund invests in a structured note that contains an embedded derivative in accordance with the description below, the Investment Manager will ensure that the maximum loss on any such structured note does not exceed the amount of the initial investment. The host contract in a structured note will not therefore add any incremental exposure or leverage to the Fund and accordingly, do not need to be included in the calculation of Global Exposure. The embedded derivative component may be an equity, currency or interest rate option. Any such embedded derivative will be looked through and included in the calculations of position and issuer exposure and in such circumstances references to FDI in this DRMP shall include the embedded derivative.

A transferable security or money market instrument embedding a FDI shall be understood as a reference to financial instruments that fulfil the criteria for

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transferable securities or money market instruments set out in the Regulations and the and which contain a component which varies in a way similar to a stand-alone FDI, has characteristics and risks that are not closely related to the host contract and has a significant impact on the risk profile and pricing of the transferable security or money market instrument.

A transferable security or a money market instrument shall not be regarded as embedding a FDI where it contains a component which is contractually transferable independently of the transferable security or the money market instrument. Such a component shall be deemed to be a separate financial instrument.

1.3.9 Warrants

A warrant is a security that entitles the holder to buy the underlying stock of the issuing company at a fixed exercise price until the expiry date.

The purpose behind the purchase of warrants by a Fund is to provide exposure to increases in the market (e.g. with respect to temporary cash positions) or to hedge against an increase in the price of a stock that a Fund intends to purchase.

1.3.10 Convertible Bonds

A convertible bond is a security that gives the holder the right to acquire the issuer's common shares directly from the issuer. The terms are specified under which this exchange can occur. The optionality component of this security, which allows for the bond holder to convert debt into equity, results in the bond holder typically receiving lower yields as compared to non-convertible securities.

1.4 Details of risks to the Funds from utilising FDI outlined above

The prices of FDI, including futures and options prices, are highly volatile. Price movements of forward contracts, futures contracts and other FDI contracts are influenced by, among other things, interest rates, changing supply and demand relationships, trade, fiscal, monetary and exchange control programmes and policies of governments, and national and international political and economic events and policies. In addition, governments from time to time intervene, directly and by regulation, in certain markets, particularly markets in currencies and interest rate related futures and options. Such intervention often is intended

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directly to influence prices and may, together with other factors, cause all of such markets to move rapidly in the same direction because of, among other things, interest rate fluctuations.

The use of techniques and FDI also involves certain special risks, including (1) dependence on the ability to predict movements in the prices of securities being hedged and movements in interest rates, (2) imperfect correlation between the hedging instruments and the securities or market sectors being hedged, (3) the fact that skills needed to use these instruments are different from those needed to select the Fund's securities and (4) the possible absence of a liquid market for any particular instrument at any particular time, and (5) possible impediments to effective portfolio management or the ability to meet redemption requests.

Market Risk

This is a general risk that applies to all investments, including FDI, meaning that the value of a particular FDI may go down as well as up in response to changes in market factors.

Liquidity Risk

There is no assurance that a liquid market will exist for any particular FDI trade. Liquidity risk arises from the inability to obtain market prices for or affect a market trade in relation to a particular instrument. If a FDI transaction is particularly large or if the relevant market is illiquid (as is the case with many OTC FDI and structured notes), it may not be possible to initiate a transaction or liquidate a position at an advantageous time or price. FX forwards and those FDI which are traded OTC are only entered into with counterparty banks having or deemed to have a minimum credit rating of A2 or equivalent² and where there is an ability to liquidate such transactions at any time at fair value.

In the case that collateral is received from a counterparty, the Fund must ensure that it is sufficiently liquid in order that it can be sold quickly at a robust price that is close to its pre-sale valuation. Cash collateral received must only be invested in risk-free assets.

² Standard & Poor's rating. An equivalent rating is one that has been provided by an eligible External Credit Assessment Institution and deemed equivalent

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Counterparty Credit and Settlement Risk

If the creditworthiness of the counterparty to an OTC contract declines, the risk that the counterparty may not perform could increase, potentially resulting in a loss to the portfolio. To limit counterparty credit risk, the Investment Manager will only enter into OTC trades on behalf of the Fund with counterparties that meet certain standards of creditworthiness having or deemed to have a minimum credit rating of A2.

Where the Fund enters into FDI transactions OTC, it will be exposed to the risk that the counterparty may default on its obligations to perform under the relevant contract and may not settle a transaction.

If there is a default by the other party to any such transaction, there will be contractual remedies; however, exercising such contractual rights may involve delays or costs which could result in the value of the total assets of the related portfolio being less than if the transaction had not been entered. Any such default could eliminate any profit potential and compel the Fund to cover its commitments for resale or repurchase, if any, at the then current market price.

Correlation Risk

Other risks in using FDI include the risk of mispricing or improper valuation of FDI and the inability of FDI to correlate perfectly with underlying assets, rates and indices.

Management Risk

FDI products are highly specialized instruments that require investment techniques and risk analyses different from those associated with stocks and bonds. The use of a FDI requires an understanding not only of the underlying instrument but also of the FDI itself, without the benefit of observing the performance of the FDI under all possible market conditions. In particular, the use and complexity of FDI require the maintenance of adequate controls to monitor the transactions entered into, the ability to assess the risk that a FDI adds to the Fund's portfolio and the ability to forecast price, interest rate or currency exchange rate movements correctly.

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Leverage Risk

Since some FDI have a leverage component, adverse changes in the value or level of the underlying asset, rate or index can result in a loss substantially greater than the amount invested in the FDI itself. Certain FDI have the potential for unlimited loss, regardless of the size of the initial investment.

1.4.1 Futures contracts

Futures contracts are highly volatile, involve certain special risks and expose investors to a high risk of loss. The low initial margin deposits normally required to establish a futures position permit a high degree of leverage. As a result, a relatively small movement in the price of a futures contract may result in a profit or a loss which is high in proportion to the amount of funds actually placed as initial margin and may result in un-quantifiable further loss exceeding any margin deposited.

In the event of adverse price movements, a Fund would continue to be required to make daily cash payments to maintain its required margin. In such situations, if a Fund has insufficient cash, it may have to sell portfolio securities to meet daily margin requirements at a time when it may be disadvantageous to do so.

Futures contracts may also be illiquid as discussed above under Liquidity Risk.

1.4.2 Forwards

Forward contracts, unlike futures contracts, are not traded on exchanges and are not standardised. Banks and dealers act as principals in these markets, negotiating each transaction on an individual basis. Forward trading is substantially unregulated and there is no limitation on daily price movements and speculative position limits are not applicable. The principals who deal in the forward markets are not required to continue to make markets in the currencies they trade and these markets can experience periods of illiquidity, sometimes of significant duration. Market illiquidity or disruption could result in losses to the Fund.

1.4.3 Swaps

Payments under a swap contract may be made at the conclusion of the contract or periodically during its term. If there is a default by the counterparty to a swap

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contract, a Fund will be limited to contractual remedies pursuant to the agreements related to the transaction.

The use of swaps involves investment techniques and risks different from and potentially greater than those associated with ordinary portfolio securities transactions. If the Investment Manager is incorrect in its expectations of market values or interest rates, the investment performance of a Fund would be less favourable than it would have been if this portfolio management technique were not used.

1.4.4 Options

As option premiums paid or received by a Fund will be small in relation to the market value of the investment underlying the options, trading in options could cause a Fund's NAV to be subject to more frequent and wider fluctuations than would be the case if a Fund did not utilise options. Upon the exercise of a put option written by a Fund, it may suffer a loss equal to the difference between the price at which a Fund is required to purchase the underlying asset and its market value at the time of the option exercise, less the premium received for writing the option. Upon the exercise of a call option written by a Fund, it may suffer a loss equal to the excess of the market value of the asset at the time of the option's exercise over the price at which the Fund is obliged to sell the asset, less the premium received for writing the option. No assurance can be given that a Fund will be able to effect closing transactions at a time when it wishes to do so. If a Fund cannot enter into a closing transaction, it may be required to hold assets that it might otherwise have sold, in which case it would continue to be at market risk on such assets and could have higher transaction costs, including brokerage commissions. In addition, options that are not exchange traded will subject a Fund to risks relating to its counterparty, such as the counterparty's bankruptcy, insolvency, or refusal to honour its contractual obligations.

1.4.5 Credit Default Swaps

Credit default swaps (**CDS**) provide a measure of protection against defaults of debt issuers. The Fund's use of CDS does not assure their use will be effective or will have the desired result.

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There is no assurance that CDS counterparties will be able to meet their obligations pursuant to swap contracts or that, in the event of default, the Fund will succeed in pursuing contractual remedies. The Fund thus assumes the risk that it may be delayed in or prevented from obtaining payments owed to it pursuant to CDS contracts. As a buyer of a CDS, the Fund is exposed to the failure to make payment by the counterparty in the event of a credit event. As a seller of a CDS, the Fund is exposed to non-payment of the periodic stream of payments over the term of the contract and to the full notional value of the reference obligation in the event of a credit event.

1.4.6 Structured Notes

Each structured note needs to be bifurcated between the host contract and the embedded derivative. The embedded derivative (e.g. an option) then needs to be viewed as a stand-alone FDI for risk management purposes and is subject to the same risks as the equivalent FDI.

A Fund may not be able to hedge its exposure to the underlying derivative should it wish to do so due to the possibility of there not being availability on the market of an equivalent offsetting FDI. Sale of a structured product may also not be possible as they may also be illiquid as discussed above under Liquidity Risk.

Structured notes will subject a Fund to risks relating to its counterparty, such as the counterparty's bankruptcy, insolvency, or refusal to honour its contractual obligations.

1.4.7 Warrants

A warrant is a time-limited right to subscribe for shares, debentures, loan stock or government securities, and is exercisable against the original issuer of the securities. Warrants often involve a high degree of gearing, so that a relatively small movement in the price of the underlying security results in a disproportionately large movement, favourable or unfavourable in the price of the warrant. The prices of warrants can therefore be volatile.

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1.4.8 Convertible Bonds

Convertible Securities: As with all debt securities, the market value of convertible securities tends to decline as interest rates increase and, conversely, to increase as interest rates decline.

Convertible securities generally rank senior to common stocks in an issuer's capital structure and are consequently of higher quality and entail less risk than the issuer's common stock. However, the extent to which such risk is reduced depends in large measure upon the degree to which the convertible security sells above its value as a fixed income security.

1.5 Description of FDI valuation rules

The value of any OTC FDI contracts will be based on a quotation from the counterparty to such contracts at the Valuation Point³ (**the VP**) and shall be valued daily. The valuation will be approved or verified weekly by a party independent of the counterparty who has been approved for such purpose by the Depositary. Alternatively, the value of any OTC FDI contract may be the quotation from an independent pricing vendor or that calculated by the Fund itself and shall be valued daily. Where an alternative valuation is used by the Fund, the Fund will follow international best practice and adhere to specific principles on such valuation by bodies such as IOSCO and AIMA.

Any such alternative valuation must be provided by a competent person appointed by the RBSCIFL Board and approved for the purpose by the Depositary, or a valuation by any other means provided that such value is approved by the Depositary. Any such alternative valuation must be reconciled to the counterparty valuation on a monthly basis. Where significant differences arise they must be promptly investigated and explained to the RBSCIFL Board.

Forward FX contracts shall be valued by reference to the prevailing market maker quotations, namely, the price as at the VP (as defined in the Prospectus and set out in the Supplement for the Fund) at which a new forward FX contract of the

³ The VP is defined as the point in time by reference to which the NAV of a Fund and the NAV per share are calculated for the relevant Fund.

Section 1 – General Information

same size and maturity could be undertaken, or if unavailable, at the settlement price provided by the counterparty. The settlement price shall be valued at least daily by the counterparty and shall be verified at least weekly by a party who is independent from the counterparty and approved for such purpose by the Depositary.

The value of any exchange traded futures contracts, share price index, futures contracts and options and other FDI shall be the settlement price as determined by the Regulated Market in question as at the VP.

1.6 Description of policy and procedures re Legal and Contractual Risk

1.6.1 Contractual Risk

The Fund will invest in exchange-traded instruments with standard legal terms. In respect of these instruments it is considered that the contractual risk is minimal.

Contractual risk is greater with OTC FDI contracts (specifically swaps, CDS and currency forward contracts) where there is risk of unforeseen circumstances affecting the counterparty to the transactions. Where OTC FDI are utilised, contracts are negotiated on an individual basis and there is a risk that such arrangements may not be legally enforceable or the transaction may not be documented correctly or that the parties may disagree as to the proper interpretation of the terms of a contract which could result in loss arising from the Fund being unable to enforce or rely on the rights and obligations arising under such contractual arrangements. Such disputes may expose a Fund to significant counterparty risk.

1.6.2 Legal Risk

There is a possibility that the agreements governing the FDI transactions may be terminated unexpectedly as a result of events outside the control of the Fund, for instance, supervening illegality or change in the tax or accounting laws relative to those transactions at the time the agreement was originated. In accordance with standard industry practice, it is the Fund's policy to net exposures against its counterparties and in accordance with COLL.

Section 1 – General Information

The Investment Manager seeks to minimize legal risk when possible by negotiating specific contractual terms with the relevant counterparty and by actively monitoring regulatory developments. The Investment Manager reviews FDI agreements, account documentation and margin or other credit support documentation in order to identify legal risk arising under applicable law or regulation or under relevant contractual obligations with FDI counterparties. When possible, the Investment Manager seeks to negotiate specific contractual terms with each counterparty to minimise such legal risk. All OTC swap transactions will be entered into pursuant to an ISDA Master Agreement with an approved counterparty.

1.6.3 Contractual review and approved counterparties

All such contracts are subject to review by the Investment Manager's and/or the Manager's legal counsel in order to minimise such risk. Where it is deemed appropriate, external legal opinion will be obtained.

A list of approved brokers and dealers is maintained and updated on a regular basis by an internal counterparty risk group at the Investment Manager.

Section 2 – Global Exposure and Leverage

Section 2: Global Exposure and Leverage

2.1 Policy on Leverage and Global Exposure

The calculation of Global Exposure and Leverage are defined in COLL as either of the following:

- (a) Incremental exposure and leverage generated by the Fund through the use of FDI including embedded derivatives which may not exceed the total of the Fund's NAV;
- (b) The market risk of the Fund portfolio.

Market risk is calculated using one of the stated risk measures (Commitment, Relative VaR or Absolute VaR).

2.1.1 Global Exposure

Consistent with its risk profile and the expected proportion of the Fund's portfolio composition comprising of FDI, the Fund will use the commitment approach for the purpose of calculating Global Exposure. This approach converts each Fund's FDI positions into the market value of equivalent positions in the underlying assets, and seeks to ensure that the Fund's FDI risk is monitored in terms of any future commitments to which it is (or may be) obligated.

In addition to using the commitment approach to measure and to monitor Global Exposure of each Fund through the use of FDI, each Fund will be monitored through the application of internal limits on the VaR of each Fund.

2.1.2 Leverage

Leverage has the affect of gearing a fund's expected performance by allowing the fund to gain a greater exposure to underlying investment opportunities. Each Fund will not be leveraged (save on a short term basis as where the Fund may borrow) other than through the use of FDI (including embedded FDI). The Fund is subject to a limitation that simple Leverage may not exceed 100% of the NAV, thus total exposure cannot exceed 200% of Net Asset Value.

Simple leverage is calculated as being Global Exposure divided by the Fund's Net Asset Value. The Investment Manager will measure Global Exposure and leverage daily. The calculation of Global Exposure is calculated after the application of the netting and hedging.

Section 2 – Global Exposure and Leverage

2.2 Netting & Hedging

In calculating the Fund's Global Exposure, issuer-concentration and cover requirements, positions may be netted:

- between FDI provided they refer to the same underlying asset, even if the maturity date of the FDI is different; or
- between a FDI (whose underlying asset is a transferable security, money market instrument or CIS) and that same corresponding underlying asset;

where the trades on FDI and/or security positions are concluded with the sole aim of eliminating the risks linked to positions taken through other FDI and/or security positions, leaving no material residual risk.

In calculating each Fund's Global Exposure, FDI hedging transactions may reduce exposure. FDI used for currency hedging purposes may be netted provided they do not add incremental exposure, leverage or market risks.

Other hedging arrangements can be taken into account when calculating Global Exposure if they offset the risks (general and specific) linked to FDI, they do not aim to generate a return, they relate to the same asset class, there is a verifiable reduction of risk at the Fund portfolio level; and they are efficient in stressed market conditions. Investment strategies that aim to generate a return will not be included as hedging arrangements.

2.3 Position Cover Requirements

A transaction in FDI which gives rise, or may give rise, to a future commitment on behalf of a Fund must be covered as follows:

- (i) in the case of FDI which automatically, or at the discretion of the Fund, are cash settled the Fund must hold, at all times, liquid assets which are sufficient to cover the exposure;
- (ii) in the case of FDI which require physical delivery of the underlying asset, the asset must be held at all times by the Fund. Alternatively the Fund may cover the exposure with sufficient liquid assets⁴ where:
 - the underlying assets consists of highly liquid fixed income securities; and/or

⁴ See 1.4 above under Liquidity Risk for the UCITS definition of liquid assets.

Section 2 – Global Exposure and Leverage

- the Fund considers that the exposure can be adequately covered without the need to hold the underlying assets.

2.4 Additional Global Exposure monitoring using VaR

In addition to using the commitment approach to measure and to monitor Global Exposure calculations for each Fund's Global Exposure will be made using a VaR model as an additional risk management control. VaR statistics are used to estimate the maximum potential loss that a Fund could suffer over a given time horizon with a specified degree of likelihood.

All the positions of each individual Fund will be included in the VaR calculation. When there are hedged share classes, VaR will be calculated for the portfolio as a whole including the share class hedging FDI.

2.4.1 VaR and the use of additional risk measures

The rationale for the inclusion of a VaR figure stems from the fact that it can, within reason, be used as a single absolute indication of portfolio risk. The figure itself captures both the underlying correlation between portfolio stocks as well as the interaction between the factors driving market risk. As a single numerical value it is indicative of an "at risk" signal.

However, the use of a VaR statistic on its own can fail to capture some of the additional dimensions to risk aligned with market expectations. To gain a wider appreciation of risk, it is therefore prudent to adopt a number of risk measures.

2.4.2 Use of Relative VaR and Absolute VaR

The use of the Relative VaR or Absolute VaR will be dependent on the investment strategy of the individual fund. Strategies suitable to the Relative VaR approach are those where a leverage free benchmark is defined for the Fund, reflecting the investment strategy that the Fund is pursuing. The use of relative VaR would also be the most transparent way for the investor, who is in general aware of the benchmark and who might have, at least implicitly, an idea of the risk of this benchmark.

Section 2 – Global Exposure and Leverage

In contrast, a Fund investing in multiple asset classes and that do not define the investment target in relation to a benchmark but rather as an absolute return target, are suited to the Absolute VaR approach. In the case that a Fund is launched under a structure that is referenced to a benchmark, and it is considered appropriate to do so, then the Fund specific Schedule to the DRMP will note that Relative VaR is being used rather than Absolute VaR.

In the case that Relative VaR is used, then Tracking Error (**TE**) may be used as part of risk to ensure the suitability of the benchmark. TE captures the correlated effects of a Fund in direct association with its prescribed benchmark.

For Funds that include a benchmark within their Investment Objective & Policy and a maximum TE, then TE is a key measure of the relative risk of the Fund irrespective of whether FDI are used. For such Funds, TE is a key part of the ongoing risk monitoring.

2.4.3 Quantitative Limits

The exposure of a Fund created through the use of FDI will be controlled through the application of one of the following limits on the VaR of the fund:

Relative VaR

- calculate the VaR of a fund's portfolio (all positions including FDI) and calculate the VaR of the benchmark and then ensure the Fund's VaR is not more than twice that of the benchmark.

Absolute VaR

- the Absolute VaR of a Fund must not be greater than 20% of the fund's NAV.

For the purposes of calculating Absolute VaR, Relative VaR and ES, a 99% confidence level, 1-tailed and 1 month time horizon (20 days) will be used. Historical simulation will be used for calculating VaR.

2.4.4 Back testing

The accuracy and performance of each Fund's VaR model (i.e. prediction capacity of risk estimates) will be monitored by conducting a back testing program. The

Section 2 – Global Exposure and Leverage

back testing will compare, for each business day, a comparison of the one-day VaR measure generated by the VaR model for the Fund's end-of-day positions to the one-day change of the Fund's NAV by the end of the subsequent business day.

This back testing will be completed at least on a monthly basis, subject to always performing retroactively the comparison for each business day as detailed above.

2.4.5 Stress testing

Stress tests are intended to highlight those areas in which a portfolio would be exposed-to-risk if the current economic conditions were likely to change. An economic event may be a simple change in the direction of interest rates or return expectations, or may take the form of a more extreme market event such as one caused through political instability, war or terrorism. The stress test itself is intended to highlight any weakness in the current portfolio construct that might deliver unnecessary systematic exposure if the market were to move. The Risk Services Provider will employ stress testing at multiple levels:

Deterministic

To analyse the change in portfolio value caused by the shock to valuation-based parameters (e.g. interest rate and credit spread shifts). This is confined to fixed income derived assets.

Parametric

To analyse the change resulting from shocks to explanatory factors:

- Volatility-based shocks: having direct impact on volatility measures (e.g. TE, VaR etc)
- Level-based shocks: having direct impact on portfolio value.

Historical scenarios

A defined set of parametric factor shocks to recreate historic stress scenarios within the current risk universes.

Stress testing will be applied regularly (as appropriate to each Fund's investment philosophy) with a minimum frequency of once per month.

Section 2 – Global Exposure and Leverage

2.5 Additional internal risk and liquidity risk management measures and limits

In addition to VaR and stress testing, the Risk Services Provider will also calculate and monitor additional appropriate internal risk management and liquidity risk management measures and limits.

2.6 Monitoring and Control

The Risk Services Provider will monitor the Fund's exposure limits and risk positions. The monitoring will include, but will not be limited to:

- Monitoring of compliance and quantitative limits
- Post Net Asset Value Investment Compliance
- Prevention of limit breaches
- Position netting
- Monitoring of fund redemptions and inflows and their impact on overall liquidity.

2.6.1 Trade Monitoring

Details of the level of operational exceptions such as errors on timely trade capture, evidence of completed reconciliations of all items in the trade life cycle, including cash, marked to market margining, unmatched and failed trades etc. is done by the Administrator and crosschecked by the Investment Manager.

Section 3 – Counterparty Risk Exposure

Section 3: Counterparty Risk Exposure

3.1 Counterparty approval

Before any counterparty may be utilised it must be approved by the Coutts Fund Counterparty Approval Committee, which is responsible for establishing the eligibility of counterparties used by the Investment Manager and ensuring that appropriate documentation is in place. The requirements for eligibility of counterparties are set out in Appendix II. A list of approved counterparties is maintained by the Investment Manager.

Counterparty eligibility is checked by the portfolio manager prior to entering into the trade by reference to a schedule of approved counterparties maintained by the Investment Manager.

In approving suitable counterparties and appropriate limits, due regard is also given to a number of risk and reputational factors including regulatory supervision and jurisdiction, management, capital adequacy and solvency ratios, historical financial performance, credit ratings, and parent company standing.

3.2 Counterparty Risk Exposure

Risk exposure to the counterparty must not exceed 5% of the NAV. This limit is extended to 10% for Approved Credit Institutions.

The counterparty exposure related to OTC FDI must be added to other non-FDI exposures that the Fund may have to the counterparty in order to ensure that overall counterparty exposure limits are not breached, i.e. the total exposure to a single counterparty arising from all activities must be captured in the risk management systems. Counterparty risk exposure is not required to be calculated for a financial instrument embedding a FDI unless the FDI is contractually transferable independently of that instrument thereby enabling the issuer to pass the credit risk of the FDI to the Fund.

Risk exposure to an OTC derivative counterparty may be reduced where the counterparty provides the Fund with collateral in accordance with section 3 of Appendix II.

Section 3 – Counterparty Risk Exposure

3.3 Counterparty Netting

The Fund may net the mark-to-market value of OTC FDI positions with the same counterparty provided the Fund has a contractual netting agreement with its counterparty which creates a single legal obligation such that in the event of the counterparty's failure to perform owing to default, bankruptcy, liquidation or any other similar circumstances, the Fund would have a claim to receive or an obligation to pay only the net sum of the positive and negative mark-to-market values of included individual transactions.

3.4 Collateral

3.4.1 Collateral – OTC FDI transactions

Risk exposure to an OTC FDI counterparty may be reduced where the counterparty will provide the Fund with collateral which is in accordance with the requirements set out in section 3 of Appendix II. Counterparty risk can be disregarded where the value of the collateral, valued at market price and taking into accounts appropriate discounts, exceeds the value of the amount exposed to risk at any given time.

Cash collateral will not be invested in instruments providing a yield greater than the generally accepted risk free return (e.g. short dated (generally 3 month) highest quality government bonds). Collateral in the form of cash deposits in a currency other than the currency of exposure will be adjusted for currency mismatch.

3.5 Counterparty Risk Exposure Calculation

Counterparty risk exposure is calculated daily as the positive mark-to-market value of the OTC FDI contract with the counterparty (nil where a negative value) after any netting applied which is in accordance with section 3.3 above.

Exchange traded FDI are deemed to be free of counterparty risk exposure subject to the following paragraph. When calculating exposure, it will be established whether exposure is to an OTC counterparty, broker or clearing house.

It is expected that all counterparties will be regulated entities and/or subject to segregation of client monies. However, exposure will be calculated from any initial margin posted to or variation margin receivable from a broker relating to

Section 3 – Counterparty Risk Exposure

exchange traded or OTC FDI, which is not protected by client money rules or other similar arrangements to protect the Fund against the insolvency of the broker.

3.6 Monitoring and control

As part of the pre-trade compliance procedures, the Investment Manager will check to gain assurance that any proposed trade will not result in a breach to the Counterparty Risk Exposure limits as shown in 3.2 above. The Risk Services Provider monitors on a daily basis the counterparty risk exposure to all counterparties to ensure that they are in compliance with the requirements as set out in the Prospectus of the Fund and Appendix II. Counterparty risk exposures for OTC FDI are tested against limitations on exposures to a single counterparty as well as limits on combined exposures to a single body. All breaches are notified when discovered as per 1.1.4 above. Breaches will be rectified at the earliest feasible opportunity and in a manner consistent with minimising loss to the fund.

Further details of reporting and escalation procedures are included in Section 4.

Section 4 – Reporting

Section 4 – Reporting

In addition to the daily reporting of any breaches to the limits as described in 1.1.3 above, the following reporting process will be followed.

4.1 Monthly reporting by the Risk Services Provider

The Risk Services Provider will provide a report on the Fund on a monthly basis which will also outline the current level of risk incurred by the Fund and any actual or foreseeable breaches to the limits, so as to ensure that prompt and appropriate action can be taken.

4.2 Escalation of material breaches and issues

Any material regulatory breaches will be escalated immediately by the Risk Services Provider to the Manager to consider the most appropriate action to be taken including notification to the RBSCIFL Board.

Detailed reports of any significant issues arising will be brought to the attention of the RBSCIFL Board. The RBSCIFL Board will review the contents of these reports and will identify what action needs to be taken to ensure that the Fund complies with COLL.

4.3 Quarterly reporting to the Board of the Manager

The Risk Services Provider will provide a report to the RBSCIFL Board at each quarterly meeting, including a report on risk monitoring during the period under review.

- (i) the consistency between the current levels of risk incurred by the ICVCs and the Fund and the risk profile agreed for the Fund;
- (ii) the compliance of the Fund with its requirements in respect to the systems used to monitor risk limits;
- (iii) the adequacy and effectiveness of the risk management procedures, indicating in particular whether appropriate remedial measures have been taken in the event of any deficiencies;
- (iv) any material and significant issues and any breaches of relevant risk limits.

Section 4 – Reporting

The RBSCIFL Board will receive regular reports on compliance matters from the Manager's other service providers. The Depositary will be required to submit a report at each RBSCIFL Board meeting which will identify any issues arising from its monitoring of the Fund's investment restrictions, restrictions on borrowing and counterparty exposure limits.

4.4 Details of procedure and content of the UCITS Annual FDI report

The Manager will prepare an annual report on the use of FDI to be submitted to the FCA (**Form 42**). This is required as at 31 October each year and submitted within 30 business days.

Appendix I – Fund Share Classes

Classes

Each Fund may comprise of one or more Share Classes. The different Share Classes available for issue in each Fund will be set out in the Prospectus. The different Share Classes in a Fund may, inter alia, have the following distinguishing features: levels of fees and expenses charging structures, and may have different Minimum Initial/Minimum Additional Investment Amounts. The different Share Classes within a Fund together represent interests in the single pool of assets maintained for that Fund.

Shares

Within each Fund and Class, the ICVCs may issue Accumulating Shares and Distributing Shares which shall represent interests in the same distinct portfolio of investments. The net income per Distributing Share may be distributed or re-invested in accordance with the dividend policy for the Fund as set out in the Prospectus and may be in the form of additional Shares to Shareholders. No declarations or distributions shall be made in respect of the Accumulating Shares. The price of Accumulating Shares shall rise by the net income earned per Accumulating Share.

RBS Investment Funds ICVC

Fund	Share Classes	Investment Manager
Global Bond Fund	Class 1 (Accumulating) Class 1 (Distributing) Class 2 (Accumulating) Class 2 (Distributing)	Coutts & Co
Managed Defensive Fund	Class 1 (Accumulating) Class 1 (Distributing) Class 2 (Accumulating) Class 2 (Distributing)	Coutts & Co
Managed Equity Growth Fund	Class 1 (Accumulating) Class 1 (Distributing) Class 2 (Accumulating) Class 2 (Distributing)	Coutts & Co
Managed Growth Fund	Class 1 (Accumulating) Class 1 (Distributing) Class 2 (Accumulating)	Coutts & Co

Appendix I – Fund Share Classes

Fund	Share Classes	Investment Manager
	Class 2 (Distributing)	
Managed Income Fund	Class 1 (Accumulating) Class 1 (Distributing) Class 2 (Accumulating) Class 2 (Distributing)	Coutts & Co
UK Equity Fund	Class 1 (Accumulating) Class 1 (Distributing) Class 2 (Accumulating) Class 2 (Distributing)	Coutts & Co

RBS Stakeholder Investment Fund ICVC

Fund	Share Classes	Investment Manager
Stakeholder Investment Fund	Class 1 (Accumulating) Class 2 (Accumulating)	Coutts & Co

Appendix II – OTC Counterparty Requirements

OTC Counterparty Requirements

Section 1 - A Fund may invest in FDI dealt in OTC provided the following are met:

1.1 Eligible counterparties to the OTC contracts are:

- (i) credit institutions authorised in the EEA, credit institutions authorised within a signatory state (other than an EEA Member State) to the Basle Capital Convergence Agreement of July 1988 (Switzerland, Canada, Japan, US) or a credit institution authorised in the UK, Jersey, Guernsey, the Isle of Man, Australia or New Zealand (“**Approved Credit Institutions**”) or
- (ii) an investment firm, authorised in accordance with the Markets in Financial Instruments Directive in an EEA Member State, or is an entity subject to regulation as a Consolidated Supervised Entity (“CSE”) by the US Securities and Exchange Commission and where subject to a credit rating by an agency registered and supervised by ESMA that rating shall be taken into account in the credit assessment process and where a counterparty is downgraded to A-2 or below (or comparable rating) by such a credit rating agency, this shall result in a new credit assessment being conducted of the counterparty without delay.

1.2 The risk exposure to the counterparty does not exceed 5% of the NAV. This limit is extended to 10% for Approved Credit Institutions listed in (i) above (risk exposure may be reduced where the counterparty provides collateral – see below).

1.3 The Investment Manager is satisfied that the counterparty will value the OTC derivative with reasonable accuracy and on a reliable basis and that the OTC derivative can be sold, liquidated or closed by an off-setting transaction at any time at the request of the Investment Manager/Fund at fair value (the OTC derivative contract must include a clause that the counterparty will close out the transaction at any time at the request of the Fund/Investment Manager at fair value unless the Investment Manager/Fund is satisfied that such a clause is not required).

1.4 The OTC FDI must be subject to reliable and verifiable valuation on a daily basis.

1.5 Eligible counterparties have been approved as detailed in 3.1 of the DRMP.

Appendix II – OTC Counterparty Requirements

Section 2 – Counterparty Risk Exposure

- 2 The counterparty risk exposure related to OTC FDI produced is expressed as a percentage of the Fund's NAV. As described above, this exposure must not exceed 5% of the Fund's NAV or 10% for certain Approved Credit Institutions and when taken together with risk exposures with the same counterparty may not exceed 20% of the Fund's NAV.

Section 3 - Collateral

3.1 Risk exposure to an OTC derivative counterparty may be reduced where the counterparty will provide the Fund with collateral.

3.2 Collateral received must be;

Non-cash collateral must, at all times, meet with the following requirements:

- Liquidity: Non-cash collateral should be highly liquid and traded on a regulated market or multilateral trading facility with transparent pricing in order that it can be sold quickly at a price that is close to pre-sale valuation.
- Valuation: Collateral must be capable of being valued on at least a daily basis and assets that exhibit high price volatility should not be accepted as collateral unless suitably conservative haircuts are in place;
- Issuer credit quality: Collateral received should be of high quality.
- Correlation: Collateral received should be issued by an entity that is independent from the counterparty and is not expected to display a high correlation with the performance of the counterparty;
- Diversification (asset concentration): Collateral should be sufficiently diversified in terms of country, markets and issuers with a maximum exposure to a given issuer of 20% of the Net Asset Value of the relevant Fund. When a Fund is exposed to different counterparties, the different baskets of collateral should be aggregated to calculate the 20% limit of exposure to a single issuer;
- Immediately available: Collateral received should be capable of being fully enforced by the ICVCs at any time without reference to or approval from the relevant counterparty; and
- Non-cash collateral received cannot be sold, pledged or reinvested by the Fund.

3.3 In the case of non-cash collateral, the collateral cannot be sold, pledged or re-

Appendix II – OTC Counterparty Requirements

invested; must be held at the risk of the counterparty; must be issued by an entity independent of the counterparty; and must be diversified to avoid concentration risk in one issue, sector or country.

3.4 In the case of cash collateral, the collateral may only be invested in accordance with the following requirements:

- (i) cash received as collateral may only be invested in the following:
 - deposits with a credit institution authorised in the European Economic Area (EEA) (EU Member States, Norway, Iceland, Liechtenstein), a credit institution authorised within a signatory state, other than an EU Member State or a Member State of EEA, to the Basle Capital Convergence Agreement of July 1988 (Switzerland, Canada, Japan, United States) or a credit institution authorised in Jersey, Guernsey, the Isle of Man, Australia or New Zealand (the Relevant Institutions);
 - high quality government bonds;
 - reverse repurchase agreements provided the transactions are with credit institutions subject to prudential supervision and the ICVCs is able to recall at any time the full amount of cash on an accrued basis;
 - short-term money market funds as defined in the ESMA Guidelines on a Common Definition of European Money Market Funds (ref CESR/10-049);
- (ii) invested cash collateral must be diversified in accordance with the diversification requirements set out above;
- (iii) invested cash collateral may not be placed on deposit with the counterparty or a related entity.

3.5 Collateral passed to an OTC derivative counterparty by or on behalf of a Fund must be taken into account in calculating exposure of the Fund to counterparty risk. Collateral passed may be taken into account on a net basis only if the Fund is able to legally enforce netting arrangements with this counterparty.

Appendix III – Conversion Methodology

1 Conversion Methodology

The commitment conversion methodology for standard FDI⁵ is always the market value of the equivalent position in the underlying asset. This may be replaced by the notional value or the price of the futures contract where this is more conservative. For non-standard FDI, where it is not possible to convert the FDI into the market value or notional value of the equivalent underlying asset, an alternative approach may be used provided that the total amount of the FDI represent a negligible portion of the UCITS portfolio.

The following steps must be taken by a UCITS when calculating Global Exposure using the commitment approach:

- (a) Calculate the commitment of each individual FDI (as well as any embedded FDI and leverage linked to EPM techniques).
- (b) Identify netting and hedging arrangements. For each netting or hedging arrangement, calculate a net commitment as follows:
 - (i) Gross commitment is equal to the sum of the commitments of the individual FDI (including embedded FDI) after FDI netting;
 - (ii) If the netting or hedging arrangement involves security positions, the market value of security positions can be used to offset gross commitment;
 - (iii) The absolute value of the resulting calculation is equal to net commitment.
- (c) Global Exposure is then equal to the sum of:
 - (i) The absolute value of the commitment of each individual FDI not involved in netting or hedging arrangements; and
 - (ii) The absolute value of each net commitment after the netting or hedging arrangements as described above; and
 - (iii) The sum of the absolute values of the commitment linked to the efficient portfolio management techniques.

⁵ Standard FDI include the embedded derivative in a structured note that has been bifurcated from the host contract

Appendix III – Conversion Methodology

The following must also be used:

- (a) The calculation of gross and net commitment must be based on an exact conversion of the FDI position into the market value of an equivalent position in the underlying asset of that FDI.
- (b) The commitment calculation of each FDI position should be converted to the base currency of the Fund using the spot rate.
- (c) Where any currency FDI has 2 legs that are not in the base currency of the fund, both legs must be taken into account in the commitment calculation.

1.4 Conversion Methodologies – Standard FDI

The following conversion methods should be applied to the non-exhaustive list of standard FDI below.

FDI	Calculation Methodology
Futures	
Bond future	Number of contracts x notional contract size x market price of the cheapest-to-deliver reference bond
Interest Rate Future	Number of contracts x notional contract size
Currency Future	Number of contracts x notional contract size
Equity Future	Number of contracts x notional contract size x market price of underlying equity share
Index Futures	Number of contracts x notional contract size x index level
Plain Vanilla Options (bought/sold puts & calls)	
Plain Vanilla Bond Option	Notional contract value x market value of underlying reference bond x delta
Plain Vanilla Equity Option	Number of contracts x notional contract size x market value of underlying equity share x delta
Plain Vanilla Interest Rate Option	Notional contract value x delta
Plain Vanilla Currency Option	Notional contract value of currency leg(s) x delta
Plain Vanilla Index Options	Number of contracts x notional contract size x index level x delta
Plain Vanilla Options on Futures	Number of contracts x notional contract size x market value of underlying asset x delta
Plain Vanilla Swaptions	Reference swap commitment conversion amount (see below) x delta
Warrants and Rights	Number of shares/bonds x market value of underlying referenced instrument x delta
Swaps	
Plain Vanilla Fixed/Floating Rate Interest Rate and Inflation Swaps	Market value of underlying (the notional value of the fixed leg may also be applied)
Cross currency Interest Rate Swaps	Notional value of currency leg(s)

Appendix III – Conversion Methodology

FDI	Calculation Methodology
Single Name Credit Default Swap	<i>Protection Seller</i> – The higher of the market value of the underlying reference asset or the notional value of the Credit Default Swap. <i>Protection Buyer</i> – Market value of the underlying reference asset
Total Return Swaps	<i>Basic Total Return Swap</i>: Underlying market value of reference asset(s) <i>Non-Basic Total Return Swap</i>: Cumulative underlying market value of both legs of the TRS
Forwards	
FX forward	Notional value of currency leg(s)
Forward Rate Agreement	Notional value

1.5 Conversion Methodologies – Embedded FDI

The following conversion methods should be applied to the non-exhaustive list below of financial instruments which embed FDI.

FDI	Calculation Methodology
Convertible Bonds	Number of referenced shares x market value of underlying reference shares x delta
Credit Linked Notes	Market value of underlying reference asset(s)
Partly Paid Securities	Number of shares/bonds x market value of underlying referenced instruments
Warrants and Rights	Number of shares/bonds x market value of underlying referenced instrument x delta

For structured notes, the embedded FDI is bifurcated from the host contract and the conversion methodology used for that type of FDI (e.g. a structured note that contains an embedded equity option is bifurcated and the embedded FDI is converted using the methodology for an equity option).