

# **NON-BANK FINANCIAL INSTITUTIONS REGULATORY AUTHORITY (NBFIRA)**

## **PENSIONS PRUDENTIAL RULES** In terms of Section 50 of the NBFIRA Act

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### **PFR2**

#### **Fund Investment Rules**

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***Effective once the new Bill is passed***

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## **1. Introduction**

### **1.1. Pension Prudential Rules**

1. The NBFIRA's Pension Prudential Rules set out the prudential requirements for regulated pension funds operating in Botswana.
2. This note sets out in draft form material that may form the basis of PFR2.

### **1.2. Definitions**

3. In these Requirements, unless the context indicates otherwise:
  - a. "Act" means the Pension and Provident Funds Act, cap 27:03, and a word or expression to which a meaning has been given in the Act, has that meaning;
  - b. "Board" means the Board of Trustees of a fund as defined in the Act;
  - c. "bond" means either a government bond or a corporate bond;
  - d. "cash" means bank notes and coins issued or caused to be issued in terms of the Bank of Botswana Act, 1996 (Act No. 19 of 1996);
  - e. "contract for differences" means a contract the purpose of which is to secure a profit or avoid a loss by reference to fluctuations in the value or price of:
    - i. an asset;
    - ii. income from such asset;
    - iii. an index of such assets or the income therefrom;
  - f. "corporate bonds" means securities and loans, other than government bonds, which are issued by a body corporate registered in terms of the law ;
  - g. "credit balances" means a credit balance in an account with, or a deposit, including a negotiable deposit and a bill accepted by, or a promissory note issued by:
    - i. an institution registered under the Banking Act, 1995 (Act No. 13 of 1995); or
    - ii. an institution incorporated outside of Botswana which would have been a banking institution under the Banking Act;
  - h. "derivatives" means an asset whose price depends on or is derived from, the price of another asset, this includes but is not limited to options, futures and contracts for differences;
  - i. "fair value" means the fair value of an asset determined by reference to the Statements of Generally Accepted Accounting Practice;
  - j. "futures contract" means a standardised contract the effect of which is that:
    - i. a person agrees to deliver to or receive from another person a certain quantity of corporeal or incorporeal things before or on a future date at a pre-arranged price; or

- ii. an amount of money will be paid to or received from another person before or on a future date according to whether the pre-arranged value or price of:
    - aa. an asset;
    - bb. an index as a means of indicator that reflects changes in the value of one or more groups of shares or securities on one or more exchanges;
    - cc. currency;
    - dd. an rate of interest; or
    - ee. any other factor,
- k. "GAAP" means the Framework of Generally Accepted Accounting Practice;
- l. "government bonds means securities issued by -
  - i. the government of Botswana;
  - ii. a local authority regional council in Botswana; or
  - iii. a body corporate established by a law of Botswana which securities have been approved by the Regulatory Authority for the purposes of these Prudential Rules generally by notice in the Gazette and subject to the conditions determined by the Regulatory Authority and specified in the notice;
- m. "holding company" means a holding company according to the Companies Act;
- n. "listed" means listed on a stock exchange or similar trading facility, which is recognised generally by the international community of institutional investors;
- o. "option contract" means a standardised contract the effect of which is that a person acquires the option:
  - iv. to buy from or to sell to another person a certain quantity of corporeal or incorporeal things before or on a future date at a pre-arranged price; or
  - v. for an amount of money to be paid to or received from another person before or on a future date according to whether the pre-arranged value or price of:
    - ff. an asset;
    - gg. an index as a means of indicator that reflects changes in the value of one or more groups of shares or securities on one or more exchanges;
    - hh. a currency;
    - ii. a rate of interest; or
    - jj. any other factor;
 is higher or lower before or on that future date than the pre-arranged value or price;
- p. "property company" means a company -
  - i. whose ownership of -
    - immovable property; or

- all of the shares in a company
  - whose principal business consists of the ownership of immovable property; or
  - which exercises control, as defined the International Accounting Standards, over a company whose principal business consists of the ownership of immovable property; or
  - constitutes, in the aggregate, 50 per cent or more of the market value of its assets;
- ii. which derives 50 percent or more of its income, in the aggregate, from:
  - investments in immovable property;
  - investments in another company which derives 50 per cent or more of its income from investments in immovable property;
 or
- iii. which exercises control, International Accounting Standards, over a company referred to in paragraph (i) or (ii);
- q. “share” means an interest in the capital of that body; includes share stock;
- r. “sponsoring employer”, means
  - i. in relation to a fund established to provide benefits for employees of a company, means the company for whom the member works, where only one company participates in a fund; any company within a group, where “group” describes a company and its subsidiaries (where the company owns at least 50% of the subsidiary), or all companies with a common holding company, and the employee works for one of the companies in such group; and
  - ii. in relation to a fund established for the employees of a body corporate other than a company including government and local authorities and bodies established by a law, the body that has the right in terms of the rules of the fund to appoint trustees other than member-elected trustees.

## **2. Prudential Investment Rules**

4. The investment rules, as set out in this Prudential Rule, are broadly based on thinking around how the South African pension fund investment rules should be amended in future. The reasons for adopting this framework include the desires for harmonisation and for efficiency in designing a framework for Botswana.
5. There are three key components to the pension fund investment rules:
  - a. Investment Strategy
  - b. Prescribed Valuation Method for Pension Fund Assets
  - c. Limitations on Kinds of Assets that will apply unless the pension fund applies for exemption from those limits and the exemption is approved in terms of section 5.

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### **3. Investment Strategy**

6. The board of each pension fund shall invest its assets in accordance with an investment strategy, which they shall establish, monitor, review and report on as set out in section 3, provided that the limits set out in section 4.4,4.5,4.7 and 1 are not exceeded without the written permission of the NBFIRA. In the case of an external fund, the limits set out in section 4.4,4.5,4.7 and 1 shall apply, not to the total of the assets of the fund, but to the proportion of the assets of the fund corresponding to liabilities in respect of the members. The process for determining, monitoring, reviewing and reporting on the investment strategy is discussed below.
7. The investment strategy will form part of the investment policy document that is submitted at the initial registration stage and as part of the annual returns to the NBFIRA (see Applications: Licensing of New Pension Fund and Service Providers).

#### **3.1. Establishment of the Investment Strategy**

8. The board shall establish an investment strategy.
  - a. This investment strategy shall take due account of:
    - i. The objectives of the fund
    - ii. The nature and term of the liabilities of the fund
    - iii. The funding methods used in the fund, including, in the case of a defined contribution fund, any smoothing of investment returns accrued to individual member accounts,
    - iv. The effect of taxation on the investment return earned,
    - v. The need to diversify the assets of the fund, and
    - vi. The risks to which the assets and the liabilities of the fund will be exposed.
  - b. Where the strategy does not restrict investment to pooled investment portfolios offered through insurance policies or collective investment schemes,
    - i. The strategy shall set out in writing what percentages of the total fair value of the assets of the fund may be invested in each of the various classes and categories of asset (the strategic asset allocation (“SAA”)), and what powers the investment manager will have to diverge from the SAA(which may be expressed as a range for the percentages in each asset class around the SAA) with, or without, the consent of the board, subject to the limits set out in section 4.4,4.5,4.7 and 1; and
    - ii. The strategy document shall include the criteria upon which investment managers shall be selected and the manner in which, and the frequency with which, their performance shall be assessed. If performance

assessment requires the use of a benchmark, such benchmark shall be included in the document.

- c. Where the fund will be investing only in pooled investment portfolios offered through insurance policies or collective investment schemes, the strategy document shall set out the criteria with which such investment portfolios shall be selected and the manner in which, and the frequency with which, their performance shall be assessed. If performance assessment requires the use of a benchmark, such benchmark shall be included in the document.

### **3.2. Consultation with Experts**

9. The board shall consult experts with sufficient skill and experience to advise the board on an appropriate investment strategy, unless the board, itself, includes members with sufficient skill and experience to perform such function.

### **3.3. Certification by the Actuary**

10. An actuary shall confirm that he or she is satisfied that the strategy is consistent with the objectives of the fund and the management of the risks to which the fund is exposed, and that the strategy will result in an appropriate relationship between the assets and the liabilities of the fund. The actuary shall issue a certificate to this effect whenever the investment strategy is changed to a material extent, or, failing such a change, at least once every three years, provided that:
  - a. If the fund is exempt from actuarial valuation, or application is to be made for such exemption, such a certificate shall accompany the request for exemption or renewal of this exemption; or
  - b. If the fund is not exempt from actuarial valuation, such certificate shall accompany either the report on the valuation submitted in terms of section 16 of the Act or the balance of the reporting required in terms of section 3.7.

### **3.4. Selection of Investment Portfolio or Investment Scheme**

11. Where the fund will hold investments registered in its own name, the board shall select investment managers whom they consider to be competent to carry out their strategy.
12. Where the fund will invest in either a collective investment scheme or a policy of insurance, the board shall select a collective investment scheme or insurance policy which will satisfy their strategy, after satisfying themselves that the manager of the collective investment scheme or insurer is competent to carry out the stated mandate for that collective investment scheme or insurance policy. The fund may enlist the advice of an investment adviser in this regard.
13. In selecting an investment manager, collective investment scheme, or insurance policy, the board members and any advisors assisting them shall disclose any actual or potential conflict of interest that they may reasonably be expected to have knowledge of, including any benefit



that they will derive personally or that will be derived by their employer as a result of the actual or potential placement of the investments of the fund.

### **3.5. Performance Monitoring**

14. The board shall monitor the performance of the investment manager, insurance policy or collective investment scheme including any comparison of performance to the benchmark identified in the strategy document, where appropriate, using the methods and frequency set out in the strategy document.

### **3.6. Review**

15. The board shall review the investment strategy either when there is a material change to the fund or in anticipation of a major change, or, failing such a change, on at least an annual basis.
16. For the purpose of this sub-rule, a material change to the fund includes inter alia :
  - a. A change of 20% or more in the membership of the fund,
  - b. A change in the benefit structure which will change the value of the accrued liabilities by 20% or more,
  - c. A change in the asset and/or liability values by more than 20% as a result of movement in the market,
  - d. The transfer of at least 20% of the assets and/or liabilities between funds, or
  - e. A change in valuation assumptions which has resulted in a change of more than 20% to the actuarial values of either the assets or the liabilities.

### **3.7. Compliance**

17. The pension fund trustees shall report annually to the regulator, providing the following information at the end of each financial year for the fund:
  - a. As required by PFR1, the split of assets by class of asset distinguishing between local investments and foreign investments with an explanation of where the asset composition is not in accordance with the strategy, if this is applicable.
  - b. A statement signed by the chairperson of the board that
    - i. The investments are being managed in accordance with the strategy document;
    - ii. The board are monitoring the performance of the investment managers, or the pooled investment portfolio/s, in accordance with the strategy document; and
    - iii. The board has reviewed the strategy with their professional advisors (who may be members of the board, or employees of the fund or employees of the sponsoring employer), including the actuary to the fund.

### **3.8. *Communication with Members***

18. The board shall report annually to members the strategy, in summary form and in such manner as shall be determined by the board (which may differ between active members, pensioners and deferred pensioners), in such a way that a typical member will be able to:
- a. Understand the objectives set for the investment manager, where investment is in assets other than pooled investment portfolios offered through policies of insurance or collective investment schemes, and reconcile these objectives with the overall investment strategy set by the board, or
  - b. Understand the strategy lying behind the selection of the particular pooled investment portfolio/s.

### **3.9. *Individual member choice***

19. Where the board offers all, or some, members choice over the investment medium in which those particular members' interest in the fund shall be invested, the board shall ensure that:
- a. Any members who are offered choice over the investment medium in which their interest in the fund is invested have access to advisors who have such skills and expertise and who will advise the members on their choice of investment medium if they do not have the skills and expertise to manage such choice themselves;
  - b. The investment portfolios in which members may invest are selected because the portfolios have strategies which are consistent with those that the trustees feel may be appropriate to members of different risk profiles and ages, or which offer members the opportunity to combine in such a way that an appropriate individual strategy may be matched;
  - c. Investment portfolios comply with the limits set out in section 4.3 and 6;
  - d. The performance of each investment portfolio is monitored and compared with criteria established by the board prior to appointment of the investment manager in a manner consistent with that set out in paragraph 14 above;
  - e. If an investment manager is not adhering to the strategy notified to the board and the members, the appointment of the investment manager is reviewed by the board and, if they decide to retain the investment portfolio as an option for members, members are informed of the failure to adhere to the strategy set out, and are invited to review their selection of investment portfolio; where the board does not retain the investment portfolio as a permitted investment option, they shall transfer members' interests in that portfolio to another portfolio of the member's choice, failing which, to the default portfolio;
  - f. The strategies adopted by the investment managers in respect of each such investment portfolio are explained to members in language that they can reasonably understand; and

- g. In case any members who are entitled to select their investment portfolio do not exercise a choice, the board shall establish a default investment option in which the fund shall invest those members' interests in the fund: Provided that such default option may include a range of investment options depending on factors such as the age of the member.

**3.10. Returns**

- 20. All pension funds must supply unaudited quarterly returns to the NBFIRA within 40 working days after the end of the quarter. The primary purpose of this is to facilitate macroeconomic management of the economy and to provide warning as early as possible of financial difficulties facing a pension fund.

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#### **4. Valuation of Assets**

##### **4.1. Valuation Methodology**

21. Valuation of assets is set out in detail in this Pension Prudential Rule. In principle, assets must be valued at fair value, except where indicated otherwise.
22. Where there is no reliable market price the valuation of an independent expert in the valuation of that type of asset or an actuarial value using a discounted cash flow approach, with assumptions as to future investment returns and growth in values of assets of the different classes consistent with the assumptions used to value the liabilities may be used.
23. If in the opinion of the Regulatory Authority a value determined in respect of an asset by a pension fund is not a fair estimate, the Regulatory Authority may determine the valuation methodology used to determine the value of the asset.
24. In addition, there are limitations on the investment of certain asset classes and investment in certain assets is prohibited.

##### **4.2. Disallowed assets**

25. Assets to be disallowed
  - a. The portion of any holding that exceeds the limits of investment set out in paragraph 4.3.

##### **4.3. Special Provision**

###### **4.3.1. Prohibitions concerning assets and certain liabilities**

26. A pension fund shall not -
  - a. Encumber its assets;
  - b. Allow its assets to be held by another person on its behalf, except where a contractual custodial relationship is in existence, noting that the asset in the case of an investment in a policy of insurance or collective investment scheme is that policy or number of units, respectively, and not whatever assets may be included within that policy of insurance or collective investment scheme, respectively;
  - c. Directly or indirectly borrow any asset;
  - d. By means of suretyship or any other form of personal security, whether under a primary or accessory obligation, give security in relation to obligations between other persons,
  - e. Include in its assets shares held directly or indirectly in its sponsoring employer, or any holding company of that sponsoring employer, in excess of

the higher of 5%, or 120% of the market capitalisation<sup>1</sup> of the share, as a percentage of the total assets of the fund,

without the approval of the Regulatory Authority, given generally or in a particular case, and subject to such conditions as the Regulatory Authority may determine.

#### **4.3.2. Derivatives**

27. A pension fund shall not invest in derivatives other than for one or more of the following reasons:

- a. For the purpose of efficient portfolio management:
- b. For the purpose of reducing investment risk, and the Actuary has agreed in writing thereto.

Provided that in respect of paragraphs a. and b., the pension fund will, or reasonably expects to, have an asset at the settlement date of the derivative instrument which matches the obligations under that instrument and from which it can discharge those obligations.

28. The board of trustees shall ensure that any agreement concluded with an investment manager for the management of any of the fund's assets shall include a limitation on the use of derivative products as stated in paragraph 27 above and as approved by NBFIRA in writing.

- a. Where the investment manager may invest in derivative products in the name of the fund, the board of trustees must get written approval of their derivative policy from their Actuary and the Regulatory Authority. In approving the policy, the fund's Actuary must take account of the fund's overall strategic investment policy, asset-liability management strategy, and risk tolerance. Such policy must be reviewed annually by the board of trustees.

#### **4.4. Limits of Investment**

29. The value of the assets held by each pension fund in respect of the kinds or categories of assets set out in the first and second columns of section 1 below, shall not exceed the percentage set out opposite each such kind or category of asset in the third column of that table, which percentage expresses a percentage of the total fair assets of the fund. In applying these limits the effective exposure will take account of the impact of any derivative holdings in that class of asset. Provided that:

- a. Assets of the kinds or categories referred to in items 7.6 and 7.7 in the first column of that table shall not exceed 90% of the total fair value of assets of the pension fund.
- b. No single asset shall comprise more than 5% of the fair value of the portfolio, unless the asset is a listed domestic equity, where the maximum is the higher of 5% and 120% of the market capitalisation percentage.

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<sup>1</sup> Market capitalisation for a particular listed company is the ratio of the number of shares issued by that company multiplied by the closing share price of those shares to the sum across all companies listed on the Botswana Stock Exchange of the number of shares in issue for each company multiplied by the closing share prices of the shares of that company, expressed as a percentage.

#### **4.5. Limits on Kind**

30. The asset held by pension funds where there is no limitation per kind of assets, include:
- a. Cash on hand in a currency which is legal tender in Botswana; and
  - b. Assets of the kinds referred to in items 7.2 and 7.3 of section 7: Provided that the limitations per institutions set out in items 7.2 and 7.3 of section 7 shall apply there-to.

#### **4.6. Collective Investments and Investment Portfolios**

31. When determining the limitations on the kinds of assets referred to in Section 1 the look through principle should be applied to investments in policies of insurance and collective investment schemes. Provided that:
- a. An insurer or collective investment scheme may report to the fund only the percentages invested in the different classes of asset and not to the percentages invested in particular investments within those classes;
  - b. Insurers and collective investment schemes are only required to report at the fund's reporting dates only, and the percentages invested in different classes of asset will not need to be continuously monitored by the funds; and
  - c. The Regulatory Authority may exempt a fund from complying with the look through principle in relation to an investment in a foreign collective investment scheme provided that the fund allocates that full investment to a particular class of asset.

#### **4.7. Limitation on Foreign Investment**

32. Subject to the transitional rules set out in section 6, no registered pension fund shall in respect of its pension fund investment strategy, invest more than 30% of its **total** assets outside Botswana.
33. Provided that assets consisting of shares in a company incorporated outside Botswana shall, if such shares have –
- a. Been designated by the Regulatory Authority for the purpose of this paragraph; and
  - b. Been acquired on the Botswana Stock Exchange
- be regarded as assets invested in Botswana.

## **5. Regulatory Authority's Exemption**

34. The Regulatory Authority may on prior written application by a fund grant such fund exemption from any of the provisions of this prudential rule upon such conditions as he or she may impose. In particular
- a. A pension fund may be exempt from some or all of the provisions relating to the investment strategy set out in section 3.
  - b. A pension fund may be exempted from the quantitative limits set out in section 1 where the pension fund demonstrates to the Regulatory Authority that the fund is of sufficient size and has access to appropriate expertise to enable it to determine and manage its own investment strategy.
  - c. A pension fund shall have a period of 12 months from the reporting date at which a breach is first reported to the Regulatory Authority in which to comply with this prudential rule: provided that the fund satisfies the Regulatory Authority that the breach was a result of market movements.

## 6. Transitional Arrangements

### 6.1. Time limit to comply

35. The Regulatory Authority may agree a time limit with a fund for that fund to comply with this rule where that fund is in breach of this rule at the time that it becomes mandatory: provided that the time limit shall not be less than 6 months from the date on which this rule becomes mandatory.

### 6.2. Limitation on Foreign Investments

*[The timeframe should be determined by NBFIRA in consultation with industry].*

36. Pension funds shall comply with the following limitations on assets invested outside Botswana until 30 June 2050, where-after the provisions in section 4.7 shall apply:

- In the period ending 30 June 2020 70%
- In the period from 1 July 2020 to 30 June 2030 60%
- In the period from 1 July 2030 to 30 June 2040 50%
- In the period from 1 July 2040 to 30 June 2050 40%
- In the period from 1 July 2050 onwards 30%



## 7. Kinds of Assets to be Held

37. The following table sets out the kind of assets that may be held by a pension fund together with limits on admissibility for calculating excess assets.

Kind of Asset	Description of Asset	Maximum Admissible Percentage of Total Asset Value [to review with industry]
<b>7.1 Cash</b>	Cash on hand in a currency which is legal tender in Botswana	No limit
<b>7.2 Credit Balances</b>	Credit balance in a current or savings account with, or a deposit (including a negotiable deposit) accepted by, a banking institution or a building society or money market instruments in terms of which such banking institution or building society is liable, including the paid up shares of a building society or deposits in the other permitted deposit taking institutions <ul style="list-style-type: none"> <li>a) Per banking institution</li> <li>b) Per building society</li> <li>c) Other permitted deposit taking institution as defined under the Banking Act.</li> </ul>	25% 20% 20%
<b>7.3 Government Bonds</b>	Bills, bonds or securities to, guaranteed by or issued by the Government of Botswana or any body corporate established by act of Parliament or local authority in Botswana that is approved by the Regulatory Authority <ul style="list-style-type: none"> <li>a) Bills, bonds or securities to, guaranteed by or issued by the Government of Botswana</li> <li>b) Per local authority or regional council authorised by law to levy rates upon immovable property</li> <li>c) Government infrastructure bonds</li> <li>d) Development bank bonds</li> <li>e) Other bonds issued by a body corporate established by a law approved by the Regulatory Authority</li> </ul>	No limit 20% 20% 20%
<b>7.4 Corporate Bonds</b>	Listed and unlisted bills, bonds or securities issued by a body corporate registered in Botswana, and <ul style="list-style-type: none"> <li>a) listed on the Botswana Stock Exchange provided that the Regulatory Authority has approved the listing criteria; or</li> <li>b) otherwise approved by the Regulatory Authority for the purposes of these Prudential Rules generally by notice subject to the conditions determined by the Regulatory Authority and specified in the notice; (in aggregate)</li> </ul>	20%
<b>7.5 Foreign Bonds</b>	Bills, bonds or securities issued by the government of or by a local authority in countries approved by the Regulatory Authority (in aggregate)	30%

	Bonds or securities issued by institutions, in countries approved by the Regulatory Authority, other than the government or local authorities (in aggregate)	20%
<b>7.6 Property</b>	Immovable property, units in collective investment schemes primarily invested in property shares, and shares in, loans to and debentures, both convertible and non-convertible, or property companies, in Botswana or deemed to be in Botswana	25%
	Immovable property, units in collective investment schemes primarily invested in property shares, and shares in, loans to and debentures, both convertible and non-convertible, or property companies, outside Botswana	10%
	Provided that the investment in a single property or property development project shall be limited to	5%
<b>7.7 Shares</b>	Preference and ordinary shares in companies (but excluding shares in property companies), convertible debentures, whether voluntarily or compulsorily convertible (but excluding such debentures of property companies), and units in collective investment schemes (but excluding units in collective investment schemes invested primarily in property shares). Provided that	70%
	a) Shares and convertible debentures in a single company listed on the BSE	the higher of 5% and 120% of the market capitalisation percentage <sup>2</sup>
	b) Unlisted shares in any single Botswana company shall be limited to	5%
	c) Unlisted shares in Botswana companies shall be limited to (in aggregate)	20%
	d) Listed shares in foreign companies listed on a foreign stock exchange shall be limited to (in aggregate)	30%
<b>7.8 Sponsoring Employer</b>	Loans and equity investment in the sponsoring employer together with loans and equity investment in the holding company of the sponsoring employer, if any.	5% or 120% market capitalisation
<b>7.9 Commodities</b>	Instruments based on the value of an underlying commodity or basket of commodities, where the instruments are settled in cash:	
	In aggregate for all such instruments:	10%
	In aggregate per commodity:	5%
	Per instrument	5%

<sup>2</sup> For example, say company X has a market capitalisation percentage of 6% (i.e. the ratio of the number of shares in issue multiplied by the market price divided by the sum, for all companies listed on the stock exchange, of number of shares in issue for each company multiplied by the market price for the company). Then the maximum amount that the fund could hold is 9% (150% x 6%).

<b>7.10 Other Assets</b>	Any other assets	2.5%
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