

**Property Derivatives Interest Group
of the Investment Property Forum**

Response to:

**CESR's Draft Advice on Clarification of Definitions concerning Eligible Assets
for Investments of UCITS, 2nd Consultation Paper (Ref: CESR/05-490b)**

1 INTRODUCTION

- 1.1 The Property Derivatives Interest Group ("**PDIG**") welcomes the opportunity to respond to CESR's Draft Advice on Clarification of Definitions concerning Eligible Assets for Investments of UCITS published October 2005 (the "**Draft Advice**").
- 1.2 PDIG is a special interest group within the IPF. In support of the IPF's aim to improve the efficiency of the UK commercial property market, the mission of PDIG is to support the development of a deep and liquid market in property derivatives. The mandate of PDIG is not restricted to derivatives based on the UK commercial property market.
- 1.3 Set up in 1988, the Investment Property Forum ("**IPF**") is now recognised internationally as the leading specialist property investment industry body in the UK. It comprises an influential network of over 1500 members, including investment agents, fund managers, bankers, lawyers, researchers, academics, actuaries and other related professionals. The IPF operates throughout the UK and is head quartered in London, with branches in Scotland, the Midlands and the North West.
- 1.4 This response has been reviewed by the PDIG Steering Committee. It has been prepared with input from PDIG members and following discussions with investment banks.

2 COMMERCIAL PROPERTY

- 2.1 Commercial property is a major investment asset throughout Europe. In the UK alone the investment market for commercial property was around GBP 269 billion¹ (EUR 400 billion) at the end of 2004.

¹ Source: Investment Property Databank.

3 COMMERCIAL PROPERTY INDICES

- 3.1 The UK Annual Index (the “**UK Annual Index**”) published by the Investment Property Databank (“**IPD**”) was established twenty years ago and tracks the three main market sectors back as far as 1971. At the end of 2004, the 243 portfolios and 11,000 properties covered by the UK Annual Index had a total value of GBP 121 billion (EUR 180 billion) – equivalent to 45% of the UK investment market².
- 3.2 Often working in partnership with a local organization, IPD also collects data for a number of other European markets including Denmark, Finland, France (IPD France Index), Germany (DIX German Index), Ireland (IPD/SCS Ireland Index), Italy, Norway, Portugal (IPD Portuguese Index), Spain (IPD Spanish Index), Sweden (SFI/IPD Swedish Index), Switzerland (IPD / Wüest & Partner Switzerland Index) and The Netherlands (ROZ/IPD Netherlands Index). In some countries other providers may already have indices that are an established benchmark for all, or specific sectors, of the underlying market.
- 3.3 PDIG believes that a commercial property index that covers a substantial number of individual properties and a substantial aggregate value of properties can satisfy all of the principles that are required of a financial index. Specifically, as detailed in Box 14 of the Draft Advice, such an index could comply with the criteria set by Art. 22a(1) of the Directive, that is:
- be sufficiently diversified;
 - represent an adequate benchmark for the market to which it refers; and
 - be published in an appropriate manner.
- 3.4 Specifically PDIG believes that the UK Annual Index and its major sub-indices do comply with these criteria since these indices:
- are well diversified;
 - have long been used as a benchmark by the majority of investors in UK property; and
 - are calculated and published in a robust, independent and appropriate manner by IPD.

² Source: Investment Property Databank.

4 PDIG RESPONSE

- 4.1 While PDIG believes that a commercial property index can satisfy all of the principles that are required of a financial index, we have a small concern regarding the detail of the index management process detailed in Box 14 of the Draft Advice, specifically in part i). Taking the UK Annual Index as an example, PDIG believes that this index measures the performance of a representative group of underlyings in a way that is meaningful and useful and that the constituents are appropriately diversified to ensure that performance is not unduly influenced by the performance of one or two components. However, while PDIG believes that the index underlyings are reasonably liquid (turnover is forecast to be of the order of GBP 40 billion in 2005 for UK commercial property³), there is no possibility that any user could replicate the full index due to the heterogeneous nature of property investments. PDIG would prefer to see this condition removed so that local regulators can use their discretion, for each type of index underlying?, as to whether the index composition is appropriate.
- 4.2 PDIG notes that, in Box 14 of the Draft Advice, CESR has specifically referred to both “hedge fund indices” and “indices based on financial derivatives on commodities”. In line with the latter, we believe that it would be helpful to state that indices based on real estate may be eligible provided that they comply with the criteria set out in Box 14.

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³ Source: Property Derivatives World conference October 2005.