

21 November 2005

The Committee of European Securities Regulators
11-13 Avenue de Friedland
75008 Paris
France

CESR'S draft advice on clarification of definitions concerning eligible assets for investments of UCITS

Dear Sirs

We refer to CESR's second consultation paper issued in October 2005 in connection with eligible assets for UCITS and take this opportunity to supplement our response in June to the first consultation paper. Our comments in our initial response still stand to the extent not incorporated in the second consultation paper. The fact that we do not reiterate these comments does not mean that we do not feel strongly about them. In addition we make the following observations referring to the Box numbers in the second consultation paper.

- **Box 1, "Transferable securities":** The draft Level 2 advice imposes a new requirement that securities must be "freely negotiable". The Directive in Article 1.8 expressly defines "transferable securities" as meaning shares in companies (or securities equivalent to shares in companies) or bonds or securitized debt. This definition is not qualified to require that such securities be negotiable and it is submitted that the reference in the third indent of Article 18.1 to "any other negotiable securities" is not intended to require shares and bonds to be "negotiable" in a strict legal sense. While the description "negotiable" is sometimes used popularly as equivalent to "transferable", interpreted strictly it means that a simple transfer of the instrument to a transferee who takes in good faith passes good title to the instrument. In fact, in the case of many securities, registration of the transferee is required to effect a valid legal transfer.
- **Box 2, "Other Transferable securities", unlisted securities:** Our comment at Box 1 with respect to negotiability also applies. In addition the requirements that there must be regular and accurate information available to the market on the security may cause difficulty in practice. It would appear that the rationale for this category was to give limited flexibility to a UCITS. By adopting the proposals this flexibility is effectively negated. The crucial test in order to meet the requirements of Article 37 is whether there is sufficient liquidity in the portfolio as a whole.
- **Box 3, Transferable securities/Closed end funds:** We do not agree with the approach recommended. No other category of transferable security imposes a further standard of appropriate investor protection safeguards.
- **Box 4, Money market instruments ("MMI"):** A few issues arise.

- 1 With respect to clarifying the criterion “normally dealt in on the money market” CESR’s level 2 draft advice says as a general rule this means instruments with a maximum maturity at issue or residual maturity of 12 months. In practice money market funds will acquire longer maturities than this but will retain a “weighted average maturity” (“WAM”) typically of less than one year
- 2 CESR requires liquidity of each security to be considered both at the asset level and the fund level in terms of affecting overall liquidity of the fund and specifies factors to be considered. Notwithstanding a UCITS obligation to maintain sufficient liquidity to satisfy redemptions in our view, to require consideration of “unit holder structure and concentration of unitholders” and “purpose of funding of unitholders”, goes beyond matters that should be considered by the UCITS.
- 3 CESR’s explanatory text states that amortization is acceptable for money market instruments (“MMI”) with short maturities ie less than 3 months. It also says that as a general rule if funds are required to invest in high quality instruments with maximum maturity of 1 year and the fund has a WAM of 60 days, amortization should be allowed. The draft Level 3 advice states that UCITS should take care to avoid deviation from market values and says that funds having these maximum maturity and WAM characteristics would usually comply with this principle. This approach is considerably more restrictive than that currently permitted by the Financial Regulator in Ireland in GN1/00 which permits (i) money market funds to value securities with a maximum residual maturity of 15 months on an amortised basis, subject to having procedures to avoid/minimize discrepancies from market values; (ii) FRNs with an annual or shorter reset date and a maximum residual value of 2 years or less (and in some cases up to 5 years) to be valued on an amortised basis and (iii) a fund which is not a money market fund to value securities with a maximum residual maturity of 6 months on an amortised basis. We strongly support the approach taken by the Financial Regulator in Ireland and we are of the view that that should be used as a guide to acceptable practice.
- **Box 6, MMI, Article 19(1)(h) :** The draft Level 2 advice lists issuer criteria, one of which requires control of information on the issuer by an independent body specializing in the verification of legal or financial documentation This requirement would at a minimum benefit from further clarification as to what is meant and ideally should be dropped.
- **Box 10, Article 1.8/Article 21, “techniques and instruments”:** The draft advice should clarify that communication of the risk management process to the relevant regulator is required only with respect to financial derivative instruments.
- **Box 15, Article 21.1, OTC Derivatives/valuation:** The draft advice gives guidance on “reliable and verifiable valuation” as either (i) having a counterparty’s valuation checked by an “independent” third party or (ii) having the valuation performed by an independent third unit within the UCITS. Clarification would be helpful to confirm that in the case of (i) the investment manager would be viewed

as independent of the UCITS and (ii) that an administrator appointed by the UCITS could undertake the valuation.

- **Box 16, Credit derivatives:** Acknowledgement of “private” information may be problematic if eg the related party is bound by confidentiality to the credit subject not to disclose details of the relevant credit relationship.

We are grateful for the opportunity to make further comments in the consultation process and would be happy to expand on or discuss any of the comments made if this would be helpful.

Yours faithfully

David Dillon

On behalf of Dillon Eustace

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