

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

London, 10 June 2005

Dear Sirs,

Re: CESR's Advice on Clarification of Definitions concerning Eligible Assets for Investments of UCITS – Consultation Paper ("Advice")

Citigroup currently acts as depositary/trustee, through different legal vehicles, to collective investments undertakings (UCITS and non-UCITS) in several European countries, as per the following table:

Country	Depositary/Trustee	Fiduciary Assets
United Kingdom	Citicorp Trustee Company Ltd	USD 58 Bn
Luxembourg	Citibank International Plc (Luxembourg branch)	USD 95 Bn
Ireland	Citibank International Plc (Ireland Branch)	USD 15 Bn
Germany	Citigroup Global Markets Deutschland	USD 1.6 Bn

Citigroup's EMEA Fiduciary Services ("EFS") is the business unit within Citigroup, charged with managing and coordinating the activities of the depositaries/trustees providing fiduciary services to collective investment undertakings in the EMEA (Europe, Middle East and Africa) region.

Citigroup EFS welcomes CESR's objective of improving the level of harmonization in the implementation of the UCITS Directives and is confident that its work will result in the creation of a true pan-European investment fund industry, in terms of both product and service (i.e. passporting).

However, as it is to be expected that the costs associated with this harmonisation process will ultimately be borne by investors, Citigroup EFS is concerned to ensure that due consideration is given to achieving a balance between harmonisation and the costs associated with the implementation of the rules and regulations required to achieve it.

Executive summary

We note CESR's comments in the Advice to the effect that investment cannot be made by an Undertaking for Collective Investment in Transferable Securities ("UCITS") in instruments such as closed-end funds and financial derivatives for the purpose of circumventing the investment limits to which a UCITS is subject pursuant to the UCITS Directives. We request that CESR consider that, in the United Kingdom, the Financial

Services Authority (“FSA”) has authorised UCITS III funds which are permitted to use total return swaps in order to gain exposure to the performance of fund of hedge funds. We understand that the FSA permits the use of total return swaps in this way on the basis that it is of view that investors benefit from the protection afforded by UCITS, while at the same time facilitating competitive product development

We are of the view that getting to a clarification as to the feasibility under UCITS III of the kind of structures described above, is of paramount importance as regards protection of both the UCITS brand and of investors. We request that CESR clarifies its position regarding this matter, in consultation with all interested parties, including the FSA.

We also note that the Advice is both detailed and prescriptive. While we strongly support clarity in interpretation, we are concerned, however, that this prescriptive approach may reduce the attractiveness of UCITS products, prevent innovation and reduce the competitiveness of the European investment fund industry vis-à-vis other retail products (such as, for example, life insurance products).

As regards the UCITS brand and the maintaining of investor confidence in it, it should be noted that the Advice, as currently drafted, will disallow investment in certain types assets which have been eligible assets since the introduction of the Directive EC/85/611. It is our interpretation, therefore, that the Advice in this respect, if implemented, will result in UCITS having to disinvest from these assets, resulting, in some cases, in preventing a UCITS from achieving its investment objectives. We are of the view that such a scenario could undermine investor confidence, particularly if it results in additional costs for investors, while creating no investor protection benefits.

Finally, we note that the EU Commission has requested of CESR that CESR deliver its technical advice in the form of an “articulated text” by 31st October, 2005. Citigroup EFS is concerned, due to the complexity of certain of the issues identified in the Advice, that this timeframe will not provide sufficient time for full consideration of these issues by the industry, its representatives, CESR and the EU Commission. Citigroup EFS strongly recommend that CESR request the EU Commission to extend the 31 October, 2005 deadline to ensure full and adequate consideration be given by all interested parties to all issues raised in the Advice.

Detailed comments

Clarification of Art.1(8) (Definition of transferable securities)

The Advice states that UCITS should take into consideration liquidity, valuation, information and transferability in deciding whether a security is a transferable security for the purposes of the Product Directive. This statements appears to re-define “transferable security”, placing new restrictions upon the UCITS and potentially making ineligible for investment, certain investments which, to date, have been eligible.

This re-defining of “transferable security” will effect the eligibility of all securities, not just structured financial instruments.

The concern of Citigroup EFS is that, as currently drafted, the Advice will add a significant additional layer of burden on UCITS. We are also concerned that ensuring compliance with the additional requirements imposed in the Advice, if implemented, will be impractical and will result in additional costs which, we believe, will ultimately be borne by investors. Moreover, Citigroup EFS is not convinced that the Advice, if

implemented, will add any additional investor protection than that delivered by the current eligible markets regime.

Finally, Citigroup EFS is of the opinion that any additional requirement placed upon “transferable securities” should be limited to “approved” rather than “unapproved” transferable securities, as otherwise, the Advice, as drafted, would seem to preclude UCITS from investing up to 10% in “unapproved” transferable securities.

Closed-ended funds as transferable securities

In our view, closed-end funds which are listed on a “regulated market” or a market with equivalent requirements should be treated, in principle, as “transferable securities”, provided that they meet the listing requirements of the market concerned and that the listing market is duly regulated. We believe that this approach will provide investors with the same protection rights as provided for by investing in an alternative security.

Nevertheless, the question arises as to whether a UCITS should be able to invest in a closed-end fund, where that closed-end fund invests in asset classes in which that UCITS would not be allowed to directly invest (e.g. property, commodities and hedge funds). While there is a need to facilitate competitive product development and, in principle, there are no grounds for discriminating, we believe there is a need to ensure that the integrity of the UCITS brand and the appropriateness of UCITS funds for retail investors are protected. We welcome CESR’s clarifications on the above.

We request that CESR consider, as an alternative, limiting investment by a UCITS in closed-end funds to 30% of its net asset value which limit is identified in Art.24 (2) of the amended UCITS Directive.

Clarification of Art. 1(9) (Definition of Money Market Instruments)

We are concerned that the following statement in the Advice “a method that would discount cash flows using the initial discount rate of the MMI without adjusting that discount rate to take into account changes in the credit spread of the issuer would not comply with these requirements”, will prevent money market funds from qualifying as UCITS.

While we agree that more sophisticated valuation models should be used for the purpose of taking into consideration changes in credit risk, we suggest that the method of linearization should still be valid for instruments with less than three months to maturity.

Also, we would recommend amending the last bullet point of heading 1 of box 4 to avoid referencing to instruments which have “low interest rate risk”, as this could prevent investment in emerging market debt.

Clarification of scope of Art. 1(8) (Definition of Transferable Securities) and “techniques and instruments” referred to in Art. 21

In general, we concur with CESR’s Advice. Nevertheless, we suggest that the reference to an “acceptably low level of risk.” in Box 10, be amended to read: “acceptable level of risk, having regard to the stated investment objectives of the fund.”

Embedded derivatives

We request that CESR consider laying down principles as regards the identification / features of embedded derivatives and their treatment and for this to be supported by guidance notes on whether certain instruments constitute embedded derivatives.

We are unclear as to the points being made by CESR in paragraphs 2 and 5 of Box 11 of the Advice.

Other collective investment undertakings

CESR has laid down its views on criteria which can be used to assess whether a collective investment undertaking is subject to supervision “equivalent to that laid down in Community law.”

Our particular concern is that the reference to “depository” would seem to prevent investment by a UCITS in a collective investment undertaking which do not have a depository, e.g. Australia and US. We request that CESR clarify its Advice in this regard.

Financial derivative instruments

The Advice in relation to financial derivative instruments again raises the issue of whether UCITS can invest in instruments which give exposure to assets classes in which UCITS cannot directly invest (e.g. property, commodities and hedge funds).

As stated, in the UK, UCITS III funds can utilise total return swaps to swap the performance of the funds holdings for the performance of fund of hedge fund indices.

The Advice suggests that such funds should not be permissible under the UCITS brand.

We consider both approaches valid, in principle, and we suggest that CESR reach a definitive position that is applied consistently across all Member States.

OTC Derivatives

We question whether it is necessary for an OTC derivative to be valued daily. In our view, the OTC Derivative should be valued, in principle, only at each valuation point.

The requirement that the valuation of the contracts by the UCITS should be compared with an estimate provided by an independent third party at least on a monthly basis will add an additional cost which will ultimately be suffered by the investors.

We agree that OTC derivatives should be regularly independently valued, but when such an independent valuation is not available, we recommend that CESR consider whether the standards for performing the valuation are adequately addressed within the risk management process.

We also note that the last sentence of the last bullet of paragraph 3 of box 15 refers to the risk analysis being submitted to the “supervisory bodies of the UCITS”. We question whether this provides additional protection or only additional burden and cost.

Credit Derivatives

The comments made above in respect of OTC derivatives apply equally to Credit Derivatives as far as daily valuation, monthly independent valuation and submission of a risk analysis are concerned.

Additionally, we question whether it is appropriate to make a distinction between the treatment of credit derivatives and other derivatives. Also, given the credit linked notes and CDO's potentially fall to be considered under "embedded derivatives", we question why Credit Default Swaps ("CDS") do not fall to be similarly considered.

In the third indent of paragraph 2 of box 16, CESR states that one of the criteria for admissibility should be that the UCITS has taken adequate measures in order to limit the risks of asymmetry of information, especially when dealing with related parties. We support this requirement. We understand that CDS are commonly either on an Index (iTraxx) on a single stock or on a basket of reference entities. Our concern over asymmetry of information is greatest in respect of CDS on a basket of reference entities.

We welcome the recommendation that the end of the transaction can only result in delivery or in the transfer of assets eligible for UCITS, including cash.

Index replicating UCITS

As regards the requirement for UCITS to have to produce and publish the tracking error of an index replicator, we support CESR's position, as we strongly believe that enhancing transparency on tax regimes and charges applied to UCITS will increase competition across service providers and Member States, with substantial benefits for the investors.

If you wish to discuss any of the points raised in our response please do not hesitate to contact me.

Yours faithfully,

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